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TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

October Term, 1938

No. 169

THE UNITED STATES, PETITIONER

vs.

FREDERICK PLEASANTS

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS

PETITION FOR CERTIORARI FILED JULY 1, 1938
CERTIORARI GRANTED OCTOBER 10, 1938

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1938

No. 169

THE UNITED STATES, PETITIONER

vs.

FREDERICK PLEASANTS

ON PETITION FOR WRIT OF CERTIORARI TO THE COURT OF CLAIMS

INDEX

1 In Court of Claims of the United States

No. 43278

FREDERICK PLEASANTS

vs.

THE UNITED STATES

I. *Petition*

Filed March 6, 1936

To the Honorable the Court of Claims of the United States:

The plaintiff, Frederick Pleasants, by his attorney, Frederick Schwertner, respectfully represents:

1. That he is a citizen of the United States and a resident of Upper Montclair, New Jersey.

2. That on March 15, 1933, pursuant to the Revenue Act of 1932, he duly filed his individual income tax return for the calendar year 1932 on Treasury Department Form 1040 with the Collector of Internal Revenue of the United States at Newark, N. J.; that the plaintiff reported in line 20 of the said return a net income of $93,888.16, consisting of income from salaries, interest and dividends in the total amount of $99,123.31 less permissible deductions for taxes paid,
2 losses and charitable contributions in the total sum of $5,235.15; that he also showed in the said return in line 32 thereof a capital net loss from the sale of assets held more than two years in the sum of $157,642.62; that he reported in line 23 of the said return the net income subject to tax in the sum of $93,888.16; that in line 36 he showed tax on net income to be the sum of $19,867.10 and in line 37 he claimed a credit against said tax in the sum of $19,705.33, being 12½ per cent of the capital net loss of $157,642.62, and reported in line 38 the difference or $161.77 as the total tax; that the plaintiff paid said income tax of $161.77 shown to be due by the said return to the said Collector of Internal Revenue on March 15, 1933, and on information and belief, avers that the said sum of $161.77 so paid by him was thereafter deposited into the Treasury of the United States of America by the said Collector; that a copy of the face of the plaintiff's said return for the year 1932 is attached hereto and made a part hereof by reference, marked Exhibit "A."

3. That the plaintiff in arriving at the said net income of $93,888.16 as shown in line 20 of the said return deducted the sum of $3,496.00, representing contributions or gifts made by him within the calendar year 1932 to the St. James Church, Community Chest, Red Cross, Salvation Army, Y. M. C. A., and other charitable institutions within the purview of Section 23 (n); that the said sum of $3,496.00 was deducted by the plaintiff because of his belief that in computing taxable net income the law authorized a deduction for

contributions to charity subject to the limitation of 15 per cent prescribed by Section 23 (n); that the disallowance by the Commissioner of Internal Revenue of the United States of the said deduction of $3,496.00 in its entirety gives rise to the complaint herein.

3 4. On January 20, 1934, the Internal Revenue Agent in charge at Newark, N. J., caused an examination to be made of the plaintiff's said return for the year 1932, and submitted a report to the said Commissioner of Internal Revenue at Washington, D. C., a copy of which is attached hereto and made a part hereof by reference, marked Exhibit B; that in his said report, the Internal Revenue Agent determined the plaintiff's net income to be the sum of $94,963.52 (before any deduction for contributions to charity), and his capital net loss from the sale of assets held more than two years to be the amount of $154,921.98 for the year 1932; that the said report showed the normal and surtaxes on the said net income of $94,963.52 to be the sum of $20,435.93 against which a credit was allowed in the amount of $19,365.24, being 12½ per cent of the capital net loss of $154,921.98, and the difference or $1,070.69 was shown to be the total tax assessable; that the said report further showed tax previously assessed in the sum of $161.77 and additional tax to be assessed in the amount of $908.92; that in computing the plaintiff's net income to be the sum of $94,963.52, the said Internal Revenue Agent disallowed as a deduction the sum of $3,496.00, representing contributions to charity, and in explanation thereof stated as follows:

"(b) Contributions disallowed in accordance with the provisions in Mim. 4028 dated June 13, 1933, pending the final decisions of the courts. Where the tax must be computed in accordance with Sec. 101 (b) of the Revenue Act of 1932, and ordinary net income reduced by the capital net loss results in a loss, there is no income against which to apply deduction for contributions."

that on about February 24, 1934, the plaintiff duly filed with
4 the said Internal Revenue Agent a protest against the disallowance of the said sum of $3,496.00, representing contributions to charity, but stated that he was willing to pay the proposed deficiency in tax of $908.92 under protest pending the final determination of the Courts on the point in issue.

5. That on April 13, 1934, the said Commissioner of Internal Revenue, through his duly authorized representative, Chas. T. Russell, Deputy Commissioner, advised the plaintiff by a letter of that date that the recommendations of the revenue agent had been reviewed and approved, and in explanation of the denial to the plaintiff of a deduction for charitable contributions stated:

"It is noted you protested the disallowance of contributions in the amount of $3,496.00. Where the tax must be computed in accordance with section 101 (b) of the Revenue Act of 1932, and ordinary net income reduced by the capital loss results in a loss, there is no income against which to apply deduction for contributions."

that a copy of the aforesaid letter of April 13, 1934, is attached hereto and made a part hereof by reference, marked Exhibit C.

6. That the said Commissioner of Internal Revenue assessed the said deficiency in tax of $908.92 for the year 1932, together with interest thereon in the sum of $60.87, aggregating $969.79, pursuant to the plaintiff's consent to the said assessment on Treasury Department Form 870, and the plaintiff paid the said sum of $969.79 to the said Collector of Internal Revenue at Newark, N. J., on May 12, 1934; that on information and belief, the plaintiff avers that the said sum of $969.79 so paid by him was thereafter deposited into the Treasury of the United States of America by the said Collector.

5 7. That on May 19, 1934, the plaintiff duly filed with the said Collector of Internal Revenue a claim for refund on Treasury Department Form 843 of the said sum of $969.79 on the ground that the sum of $3,496.00, representing contributions to charity, was a permissible deduction, and the said Collector thereafter transmitted the said claim to the Commissioner of Internal Revenue at Washington, D. C.

8. That on December 29, 1934, the said Commissioner of Internal Revenue, through his duly authorized representative, Chas. T. Russell, Deputy Commissioner, advised the plaintiff by a letter of that date of the disallowance of the plaintiff's claim for refund in the amount of $969.79 for the year 1932, and in explanation of the denial to the plaintiff of the deduction for charitable contributions stated:

"* * * Since the capital loss of $154,921.98 is in excess of adjusted ordinary net income of $94,963.52 (without contributions) there is no net income against which to make a deduction for contributions. Contributions claimed in the amount of $3,496.00 cannot therefore be allowed."

that a copy of the aforesaid letter of December 29, 1934, is attached hereto and made a part hereof by reference, marked Exhibit D; that thereafter the said Commissioner of Internal Revenue disallowed plaintiff's said claim for refund by registered mail in accordance with Section 1103 (a) of the Revenue Act of 1932.

9. That the action of the said Commissioner in denying to the plaintiff a deduction for charitable contributions in the amount of $3,496.00 for the year 1932 because his capital net loss exceeded his adjusted ordinary net income was based solely upon the said
6 Commissioner's wrongful interpretation of the Revenue Act of 1932; that the said action of the said Commissioner of Internal Revenue was not warranted by any law of the United States or by any regulation having the force of law and was in conflict with and a denial of the rights of the plaintiff; that Section 23 of the Revenue Act of 1932 provides that in computing net income there shall be allowed as deductions: * * *

"(n) Charitable and Other Contributions. In the case of an individual, contributions or gifts made within the taxable year to or for the use of: * * *

"(2) a corporation, or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual; * * * to an amount which in all the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this subsection. * * *"

that the net income of the plaintiff for the year 1932 was in the amount of $94,963.52, as computed without the benefit of Section 23 (n), as shown in the said Internal Revenue Agent's report dated January 20, 1934, attached hereto as Exhibit B, which report was approved by the Commissioner of Internal Revenue, and the said amount was treated as net income by the said Commissioner for the purpose of assessing the normal and surtaxes imposed by Sections 11 and 12 of the Revenue Act of 1932; that the limitation of 15 per cent prescribed by Section 23 (n) on the deduction for contributions to charity applies to net income and not to ordinary net income minus capital net loss; that the plaintiff's net income of
7 $94,963.52 (before any deduction for contributions to charity) affords the base for applying the 15 per cent limitation specified in Section 23 (n) and since the plaintiff's contributions to charity to the amount of $3,496.00 are not in excess of 15 per cent of such net income, the said Commissioner was not warranted in disallowing the deduction of $3,496.00 or any part thereof; and there is justly due the plaintiff the said sum of $969.79, comprising income taxes in the amount of $908.92 and interest in the sum of $60.87, together with interest on the said sum of $908.92 from May 12, 1934, the date of payment thereof by the plaintiff, after allowing all just credits and set-offs.

10. That the plaintiff has always borne true allegiance to the Government of the United States and has not in any way voluntarily aided, abetted or given encouragement to rebellion against said Government; that he has not assigned his claim herein or any part thereof, and that he is justly entitled to the amount claimed.

Wherefore, plaintiff prays this Honorable Court to enter judgment in his behalf against the defendant in the sum of $969.79 together with interest on the sum of $908.92 from May 12, 1934, and for such other and further relief as may be required.

FREDERICK PLEASANTS,
By (Signed) FREDERICK SCHWERTNER,
His attorney in fact.

FREDERICK SCHWERTNER,
Attorney for Plaintiff,
1000 National Press Building, Washington, D. C.

8 *Duly sworn to by Frederick Schwertner; jurat omitted in printing.*

9

INDIVIDUAL INCOME TAX RETURN

FOR NET INCOMES FROM SALARIES OR WAGES OF MORE THAN $5,000 AND INCOMES FROM BUSINESS, PARTNERSHIP, RENTS, OR SALE OF PROPERTY

For Calendar Year 1932

Do Not Write in These Spaces

Exhibit "A."

FREDERICK PLEASANTS

483 Park Street,

Upper Montclair Essex N.J.

Occupation, Business, or Profession Retired merchant

1. Are you a citizen or resident of the United States? Yes
2. If you filed a return for 1931, to which Collector's office was it sent? Yes, Newark
3. Is this a joint return of husband and wife? No
4. State name of husband or wife if a separate return was made and the Collector's office to which it was sent Blanche R. Pleasants Newark
5. Were you married and living with husband or wife on the last day of your taxable year? Yes
6. If not, were you on the last day of your taxable year supporting in your household one or more persons closely related to you? No
7. How many dependent persons (other than husband or wife) under 18 years of age or incapable of self-support received their chief support from you during your taxable year? None
8. If your status in respect to question 5, 6, or 7 changed during the year, state date and nature of change No change
9. State whether your books are kept on cash or accrual basis Cash

INCOME

1. Salaries, Wages, Commissions, Fees, etc. Nat. Bellas Hess Co., New York	$900		900	00
" " " " " " Director's fees			120	00
2. Income from Business or Profession. (From Schedule A)				
3. Interest on Bank Deposits, Notes, Corporation Bonds, etc. (except interest on tax-free covenant bonds)		10	288	62
4. Interest on Tax-free Covenant Bonds Upon Which a Tax was Paid at Source				
5. Income from Partnerships, Syndicates, Pools, etc.				
6. Income from Fiduciaries.				
7. Rents and Royalties. (From Schedule B)				
8. Profit from Sale of Real Estate, Stocks, Bonds, etc. (From Schedule C)				
9. Taxable Interest on Liberty Bonds, etc. (From Schedule D)			922	25
10. Dividends on: (a) Stock of Domestic Corporations subject to taxation under Title I of 1932 Act		85	761	94
(b) Stock of Domestic Corporations not subject to taxation under Title I of 1932 Act				
(c) Stock of Foreign Corporations & bonds			430	50
11. Other Income. (a)				
(b)				
12. TOTAL INCOME IN ITEMS 1 TO 11		99	123	31

DEDUCTIONS

13. Interest Paid.			
14. Taxes Paid. (Explain in Schedule F)	1	639	15
15. Losses by Fire, Storm, etc.		100	00
16. Bad Debts.			
17. Contributions. (Explain in Schedule F)	3	496	00
18. Other Deductions Not Reported Above. (Explain in Schedule F)			
19. TOTAL DEDUCTIONS IN ITEMS 13 TO 18	5	235	15
20. NET INCOME (Item 12 minus Item 19)	93	888	16
21. Less: Net loss for 1931			
22. NET INCOME FOR TAX COMPUTATION (Item 20 minus Item 21)			

COMPUTATION OF TAX (See Instruction 23)

23. Net Income Subject to Tax		93 888	16
24. Less: Interest on Liberty Bonds, etc.	922 25		
25. Dividends	85761 94		
26. Personal Exemption	2500 00		
27. Credit for Dependents			
28. Total of Items 24 to 27	$89184 19	89 184	19
29. Balance subject to Normal Tax		4 703	97
30. Amount taxable at 4%		4 000	00
31. Amount taxable at 8%		703	97
32. Amount of Capital Net Gain or Loss		157 642	62

33. Normal Tax	160	00
34. Normal Tax	56	31
35. Surtax on Item 23	19 650	72
36. Tax on Net Income	$19 867	10
37. Adjustment for Capital Gain or Loss	19 705	33
38. Total Tax	$ 161	77
39. Less: Income Tax Paid at Source		
40. Income Tax Paid to a foreign country or U. S. possession		
41. Balance of Tax	$ 161	77

AFFIDAVIT

I swear (or affirm) that this return, including the accompanying schedules and statements, has been examined by me, and to the best of my knowledge and belief is a true and complete return, made in good faith, for the taxable year stated, pursuant to the Revenue Act of 1932 and the Regulations issued thereunder.

(See Instruction 27)

Sworn to and subscribed before me this 14th day of March, 1933.

(Signed) Frederick Pleasants

NOTARIAL SEAL

(Signed) H. C. Husk

An amended return must be marked "Amended" at top of return. Checks and drafts will be accepted only if payable at par.

11 *Exhibit B to petition*

TREASURY DEPARTMENT,
INTERNAL REVENUE SERVICE,
Feb. 9, 1934.

Office of Internal Revenue Agent in Charge, 106 Halsey St., Newark, N. J.

In re: Review of Income Tax Return.
Date of report: Jan. 20, 1934.

RECOMMENDATION

Year 1932; Additional Tax, $908.92; Overassessment—; Penalties—.

FREDERICK PLEASANTS,
438 Park Street, Upper Montclair, New Jersey.

SIR: The recommendations which this office proposes to make with respect to your income tax liability as the result of a recent examination by an internal revenue agent are shown in the statement attached.

If you acquiesce in the proposed tax liability the inclosed Form 870 should be executed and forwarded to this office. Your consent on Form 870 to the prompt assessment of any deficiency indicated will stop the running of interest to be assessed on such deficiency under the provisions of section 283 (d) of the Revenue Act of 1926 or section 292 of the Revenue Act of 1928, upon a date not later than thirty days after the filing of Form 870 properly executed. Unless such consent is filed the interest to be assessed under the law upon any deficiency indicated runs to the date the deficiency is assessed and the assessment may be made only as provided by section 274 (a) of the Revenue Act of 1926 and/or section 272 (a) of the Revenue Act of 1928.

Should you desire to make immediate payment without awaiting formal assessment and notice and demand, you should communicate with the collector of internal revenue at Newark, N. J., inclosing this letter, or a copy thereof. If payment is so made the interest period will terminate on the date of payment.

12 If you do not acquiesce in the proposed recommendations you should file a protest in writing with this office within 10 days from the date of this letter. Any protest so filed will be given careful consideration, and, if you so desire, you will be given an opportunity for a hearing before the recommendations are forwarded to Washington.

Arrangements will be made by this office upon your request to answer any questions which may occur to you in your review of these recommendations.

In any event please sign the inclosed form acknowledging receipt of this letter and related papers and return such form to this office.

Respectfully,

R. T. MILES,
Internal Revenue Agent in Charge.
By (Signed) JOHN J. MORGAN,
Internal Revenue Agent.

Inclosures:
- Statement of adjustments.
- Form 870.
- Form of acknowledgment.

1

In re: Frederick Pleasants

PRELIMINARY STATEMENT SUMMARY

Year: 1932— Additional Tax: $908.92.
Net additional tax: $908.92.
Principal causes of additional tax: Disallowance of contributions, and transfer of loss on mortgages from capital loss to ordinary loss.
Findings were discussed with the taxpayer, who will send check upon receipt of report, but does not care to sign agreement.

13 2

Form 886J–Rev. Nov. 1930.
Treasury Department,
Internal Revenue Service.
Name Frederick Pleasants.

Schedule No. 1

BLOCK ADJUSTMENTS

	Return	Additions to income	Deductions from income	Corrected
1. Salaries	$1,020.00			$1,020.00
2.				
3. Interest	10,988.62			10,988.62
4.				
5.				
6.				
7.				
8. Profit on mortgages			(a) (2,420.64)	(2,420.64)
8a.				
9. Liberty bond interest	922.25			922.25
10. Dividends	85,761.94			85,761.94
(c) Bonds	430.50			430.50
12.	99,123.31			96,702.67
13.				
14. Taxes	1,639.15			1,639.15
15. Losses	100.00			100.00
16.				
17. Contributions	3,496.00	(b) 3,496.00		
18.				
	5,235.15			1,739.15
Total income	93,888.16	3,496.00	(2,420.64)	94,963.52

3

In re: Frederick Pleasants

SCHEDULE 1–A

(a) Taxpayer held second and third mortgages on property
14 for $2,420.64. The Building & Loan Association, holder of the first mortgage, foreclosed and the taxpayer lost his entire investment.

Inasmuch as the loss was not a result of sale or exchange it is allowable as a bad debt instead of a capital loss. Art. 193, Reg. 77.

(b) Contributions disallowed in accordance with the provisions in Mim. 4028 dated June 13, 1933, pending the final decisions of the courts. Where the tax must be computed in accordance with Sec. 101 (b) of the Revenue Act of 1932, and ordinary net income reduced by the capital net loss results in a loss, there is no income against which to apply deduction for contributions.

4

In re: Frederick Pleasants

SCHEDULE 1–B—COMPUTATION OF CAPITAL NET LOSS

Cost of National Bellas Hess & Co.'s stock as per report for the year 1931:

Sold in 1931—	30,347 shares	at $8.384	$254, 429. 24
	10,865 "	at 8.384	91, 092. 16
	19,482 "	Balance	$163, 337. 08
Sold in 1932—	19,482 shares		$8, 415. 10
Cost	19,482 "	at $8.384	163, 337. 08
Loss			$154, 921. 98

15

Form 886P–Rev. Aug., 1932.
Treasury Department,
Internal Revenue Service.
Name of Taxpayer Frederick Pleasants.

SCHEDULE NO. 2—COMPUTATION OF TAX

		Year period ended 1932
Net income (from Schedule 1)		$94, 963. 52
Less: Net loss (section 117 of 1928 or 1932 Act)		
Capital net gain		
Income subject to surtax		$94, 963. 52
Less: Dividends	$85, 761. 94	
Interest on Liberty Bonds, etc	922. 25	
Personal exemption and credit for dependents	2, 500. 00	89, 184. 19
Balance subject to normal tax		$ 5, 779. 33
Normal tax at 4% on $4,000.00	$ 160. 00	
Normal tax at 8% on $1,779.33	142. 35	
Surtax on $94,963.52	20, 133. 58	
Tax at 12½ on capital net loss of $154,921.98	(19, 365. 24)	$ 1, 070. 69
Total tax		$ 1, 070. 69
Total tax assessable		$ 1, 070. 69
Tax previously assessed		161. 77
Additional tax to be assessed		$ 908. 92

16 6

Form 886–T–August, 1928.
Treasury Department,
Internal Revenue Service.
Name Frederick Pleasants.

STATEMENT OF TOTAL TAX LIABILITY

Year 1932; tax previously assessed $161.77; adjustments proposed in accompanying report, deficiency overassessment, $908.92; correct tax liability $1,070.69.

Exhibit C to petition

TREASURY DEPARTMENT,
Washington, Apr. 13, 1934.

Office of Commissioner of Internal Revenue.
IT: AR: B–2.
EYL.

Mr. FREDERICK PLEASANTS,
483 Park Street, Upper Montclair, New Jersey.

SIR: Reference is made to the report of the internal revenue agent in charge at Newark, New Jersey, a copy of which was furnished you on February 9, 1934, covering an examination of your books of account and records for the year 1932 and disclosing a deficiency in tax of $908.92 as a result of transferring a loss of $2,420.64 from Schedule D to Schedule C, disallowing contributions claimed in the amount of $3,496.00 and decreasing the loss claimed on National Bellas Hess Company stock from $155,221.98 to $154,921.98.

The recommendations of the revenue agent have been reviewed and approved in this Office.

It is noted you protested the disallowance of contributions
17 in the amount of $3,496.00. Where the tax must be computed in accordance with section 101 (b) of the Revenue Act of 1932, and ordinary net income reduced by the capital loss results in a loss, there is no income against which to apply deduction for contributions.

Pending the decision of the courts as to the correct determination of the 15 per cent limitation for contributions in relation to capital gains and losses, it is noted you stated you are willing to make payment of the deficiency in tax of $908.92 and would protect your interests by filing claim for refund.

Your attention is therefore called to the advantages of signing Form 870 enclosed.

The signing of this form will expedite the closing of your return by permitting an early assessment of the deficiency and preventing the accumulation of interest charges, since the interest period terminates thirty days after the receipt of the enclosed form, or on the

date assessment is made, which ever is earlier. If this form is not executed and filed, interest at the rate of 6 per cent per annum will accumulate.

If you execute the enclosed Form 870 please forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT: AR: B-2-EYL.

Since it is desired to bring this matter to a conclusion as promptly as possible, a response to this letter within fifteen days will be appreciated.

Respectfully,

CHAS T. RUSSELL,
Deputy Commissioner.
By (Signed) H. B. ROBINSON,
Head of Division.

Enclosure:
Form 870.

18 *Exhibit D to petition*

TREASURY DEPARTMENT,
Washington, Dec. 29, 1934.

Office of Commissioner of Internal Revenue.
IT: AR: B-2.
EYL.

Mr. FREDERICK PLEASANTS,
483 Park Street, Upper Montclair, New Jersey.

SIR: Reference is made to your claim for refund in the amount of $969.79, income taxes for the taxable year 1932.

Your claim is based on the contention that contributions in the amount of $3,496.00 should not be disallowed in the computation of your income tax liability.

In this connection you are advised that in the cases of Susan Dwight Bliss v. Commissioner and William Albert Harbison v. Commissioner, decided November 5, 1934, the Supreme Court of the United States decided that the base for computing the 15 per cent limitation on contributions is the gross income less all permissible deductions save contributions, regardless of whether the tax is computed under the capital net gain or net loss provisions of the Revenue Acts prior to the Revenue Act of 1934.

In accordance with the above decision the ordinary net income must be reduced by the amount of the capital net loss in order to arrive at the base on which to compute the 15 per cent limitation for contributions. Since the capital loss of $154,921.98 is in excess of adjusted ordinary net income of $94,963.52 (without contributions) there is no net income against which to make a deduction for contributions. Contributions claimed in the amount of $3,496.00 cannot therefore be allowed.

For the foregoing reason, your claim will be disallowed. Official notice of the disallowance of your claim will be issued by registered mail in accordance with section 1103 (a) of the Revenue Act of 1932.

Respectfully,

CHAS. T. RUSSELL,
Deputy Commissioner.
By (Signed) H. B. ROBINSON,
Head of Division.

19 II. *General traverse*

Filed April 15, 1936

And now comes the Attorney General, on behalf of the United States, and answering the petition of the claimant herein, denies each and every allegation therein contained; and asks judgment that the petition be dismissed.

ROBERT H. JACKSON,
Assistant Attorney General.

III. *Argument and submission of case*

On January 18, 1938, this case was argued and submitted on merits by Mr. Frederick Schwertner, for plaintiff, and by Mr. John A. Rees, for defendant.

20 IV. *Special findings of fact, conclusion of law, and opinion of the court by Littleton, J.*

Filed April 4, 1938

Mr. Frederick Schwertner for the plaintiff.

Delafield, Thorne & Marsh; Lowenhaupt, Waite & Stolar; George H. Warrington, and Wright & Rundle were on the brief.

Mr. Frederick E. S. Morrison amicus curiae, and Drinker, Biddle and Reath were on the brief.

Mr. John A. Rees, with whom was Mr. Assistant Attorney General James W. Morris, for the defendant.

Mr. Robert N. Anderson and Mr. Fred K. Dyar were on the brief.

In this case plaintiff seeks to recover $969.79, with interest, alleged overpayment of income tax for 1932 and interest thereon, on the ground that the Treasury Department erroneously and illegally refused to allow him a deduction in accordance with section 23 (n) of the Revenue Act of 1932 of $3,496 for charitable contributions made within the taxable year.

Plaintiff had a capital net loss of $154,921.98, which, by express provision of the statute, was not, in the case at bar, a permissible deduction, and could not be deducted by the taxpayer or the department in determining the net income of plaintiff which was to be subjected to the tax imposed by sections 11 and 12 of the Revenue Act of 1932. The net income of plaintiff for the taxable year, that is, the net amount upon which he was subject to tax after allowing
21 all authorized and permissable deductions, except charitable contributions, was $94,963.52. In determining whether plaintiff was entitled to any deduction from taxable net income because of his contributions to charity, the Commissioner of Internal Revenue held that the capital net loss above mentioned should be deducted from "ordinary income" in order to determine whether plaintiff had

a "net income" within the meaning of Section 23 (n) for the purpose of the allowance of the deduction for charitable contributions under that section. By this process there was produced a net loss from all operations for the year of more than $59,000. The Commissioner, therefore, held that plaintiff had no "net income" for the purpose of the deduction for charitable contributions but, at the same time, he held, as provided by Section 101, that the capital net loss was not a deduction for the purpose of determining "net income" subject to tax and proceeded to levy and collect from plaintiff a tax at the rates prescribed by the statute upon a net income of $94,963.52 less the authorized credit against the tax thus determined of 12½ percent of the capital net loss of $154,921.98. Plaintiff contends that the method employed by the Commissioner to deny any deduction for charitable contributions was erroneous and illegal for the reason that the base for the calculation of the deduction for charitable contributions, which the statute limits to 15 percent of the net income, is the net amount upon which the taxpayer is subject to be taxed—the base for the calculation of the tax. Counsel for defendant contend that the Commissioner's method was correct and in accordance with the provisions of the Revenue Act of 1932.

Special findings of fact

1. For 1932 plaintiff filed his individual income tax return on March 15, 1933, showing a total tax of $161.77, which was paid on the same date. He reported his income, deductions, losses, and tax as shown in the return attached to the petition as exhibit B, which is made a part hereof by reference. In that return he reported in line 12 a total income of $99,123.31 consisting of salaries, interest, and dividends, and on line 19 of the return he reported total
22 deductions of $5,235.15 consisting of taxes paid, losses by fire, storm, etc., and, under item 17, contributions. Plaintiff also reported in line 32 of the return under the heading "Computation of Tax" a capital net loss of $157,642.62.

2. In arriving at the total deduction of $5,235.15 shown on line 19 of this return, plaintiff included therein as a deduction the amount of $3,496, representing contributions or gifts made by him within the taxable year 1932 to the St. James' Church, Community Chest, Red Cross, Salvation Army, Y. M. C. A., and other charitable institutions, within the purview of section 23 (n) of the Revenue Act of 1932.

3. The Commissioner of Internal Revenue caused an investigation and audit to be made of plaintiff's books and records, and his return for 1932, and, on January 20, 1934, pursuant to the instructions of the Commissioner, the Internal Revenue Agent in Charge at Newark, New Jersey, made such investigation and audit and on February 20, 1934, prepared and submitted a report to the Commissioner. A copy of this report, consisting of five pages, is attached to the petition as exhibit D and is made a part hereof by reference.

The Internal Revenue Agent in Charge determined the plaintiff's gross income to be $96,702.67 instead of $99,123.31, as reported by plaintiff on line 12 of his return, and the total deductions to be $1,739.15 instead of $5,235.15, as reported by plaintiff on line 19 of his return. In so reducing the total deductions from $5,235.15, as reported by plaintiff, to $1,739.15, the Internal Revenue Agent in Charge disallowed as a deduction the charitable contributions in the amount of $3,496, as set forth in finding 2, on the ground that the capital net loss was a proper deduction in determining the "net income" for the purpose of the deduction for charitable contributions under section 23 (n), and since the ordinary net income reduced by the capital net loss resulted in a net loss for the year there was no income against which to apply the deduction for charitable contributions. The Internal Revenue Agent in Charge also determined plaintiff's capital net loss to be $154,921.98 instead of $157,642.62, as reported on line 32 of the return. The total tax assessable against the plaintiff as shown in the audit by the Internal Revenue Agent in Charge as set forth in his report hereinbefore mentioned was
23 $1,070.69, or $908.92 in excess of $161.77, which amount the plaintiff had reported and paid as set forth in finding 1. This additional tax resulted entirely from the disallowance of the deduction for charitable contributions in determining net income subject to tax.

4. The Commissioner upon examination and audit of plaintiff's return in connection with the report of the Internal Revenue Agent in Charge, approved the findings, audit, and computation of the tax recommended by the Revenue Agent in Charge and so notified plaintiff on April 13, 1934. Plaintiff's taxable net income for 1932 was $94,963.52 before any deduction for charitable contributions. The deficiency in tax of $908.92, together with interest thereon of $60.87, aggregating $969.79, was thereafter assessed and upon demand the same was paid May 12, 1934.

5. Thereafter, May 19, 1934, plaintiff duly filed a timely claim for refund for $969.79 for 1932 on the ground that the amount of $3,496 representing contributions to charity, being less than 15 per cent of his taxable net income, was a proper and legal deduction under section 23 (n) of the Revenue Act of 1932 in computing his net income subject to tax. The Commissioner rejected this claim in its entirety on January 17, 1935, giving as his reasons therefor the following:

"In this connection you are advised that in the cases of Susan Dwight Bliss, v. Commissioner and William Albert Harbison v. Commissioner, decided November 5, 1934, the Supreme Court of the United States decided that the base for computing the 15 per cent limitation contributions is the gross income less all permissible deductions save contributions, regardless of whether the tax is computed under the capital net gain or net loss provisions of the Revenue Acts prior to the Revenue Act of 1934.

"In accordance with the above decision the ordinary net income must be reduced by the amount of the capital net loss in order to arrive at the base on which to compute the 15 per cent limitation for contributions. Since the capital loss of $154,921.98 is in excess of adjusted ordinary net income of $94,963.52 (without contributions) there is no net income against which to make a deduction for contributions. Contributions claimed in the amount of $3,496.00 cannot therefore be allowed."

24 6. If plaintiff is correct in his contention that the charitable contributions totaling $3,496 for 1932 constituted a proper and legal deduction from his net income which was subject to be taxed under the Revenue Act of 1932 without diminution on account of the capital net loss sustained for that year, he is entitled to recover the additional tax and interest collected thereon totaling $969.79, together with interest on this amount from May 12, 1934.

Conclusion of law

Upon the foregoing special findings of fact, which are made a part of the judgment herein, the court decides, as a conclusion of law, that the plaintiff is entitled to recover $969.79, with interest as provided by law.

It is therefore adjudged and ordered that the plaintiff recover of and from the United States nine hundred sixty-nine dollars and seventy-nine cents ($969.79) with interest at the rate of six percent per annum from May 12, 1934, to such date as the Commissioner of Internal Revenue may determine in accordance with the provisions of section 177 (b) of the Judicial Code, being a part of the Revenue Act of 1928.

Opinion

LITTLETON, Judge, delivered the opinion of the court:

All of the sections hereinafter mentioned are found in the Revenue Act of 1932, unless otherwise stated. Section 23 (n) relating to charitable contributions, which is in substance the same as the provisions covering that subject incorporated in all the revenue acts beginning with section 1201 (2) of the Revenue Act of October 3, 1917, provides as follows:

"In computing net income there shall be allowed as deductions: * * *

"(n) Charitable and Other Contributions.—In the case of an individual, contributions or gifts made within the taxable year to or for the use of: * * * (2) a corporation, or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educa-
25 tional purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual; * * * to an amount which in all the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this subsection. * * *"

Section 21 provides that the "'Net income' means the gross income computed under section 22, less the deductions allowed by section

23." Sections 11 and 12 relating to the tax on individuals impose a normal tax of 4 and 8 percent and a surtax ranging from 1 to 40 percent "upon the net income of every individual."

The question in this case is whether "the taxpayer's net income" mentioned in section 23 (n), quoted above, means the net income which the statute subjects to the tax imposed by sections 11 and 12—that is, the net amount upon which the taxpayer is liable for a tax, except for its reduction for charitable contributions—or whether "the taxpayer's net income," which section 23 (n) makes the base for the calculation of the allowable deductions for charitable contributions, means the taxpayer's gross income less the deductions allowed by section 23 (other than charitable contributions) plus the deduction of the capital net loss which is not a permissible or allowable deduction under section 23 or any other section in determining "the net income" to be subjected to the tax imposed by sections 11 and 12, except under certain circumstances not material here, but which will hereinafter be referred to. It is our opinion that the net income specified in section 23 (n) as the base for the calculation of the deduction for charitable contributions is, and was, intended by Congress to be the net amount upon which the taxpayer is taxable under sections 11 and 12—i. e. $94,963.52. This was plaintiff's gross income less all permissible deductions. Where there is a "capital net loss" as defined by the statute, such loss, by express provision of the statute, is excluded and denied as a deduction in determining the net income to be subjected to the tax imposed. See section 101 (c) (7). The pertinent sections of the Revenue Act of 1932, so far as material here, are as follows:

26 "SEC. 11. Normal Tax on Individuals.—There shall be levied, collected, and paid for each taxable year upon the *net income* of every individual a normal tax equal to the sum of the following: * * *

"SEC. 12. Surtax on Individuals.—(a) Rates of surtax.—There shall be levied, collected, and paid for each taxable year upon the *net income* of every individual a surtax as follows: * * *

"SEC. 21. Net Income.—'Net income' means the gross income computed under Section 22, less the deductions allowed by section 23.

"SEC. 22. Gross Income.—(a) General Definition.—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service, * * * or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, * * *; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

"SEC. 23. Deductions from Gross Income.—In computing *net income* there shall be *allowed* as deductions: (a) Expenses * * * (b) Interest * * * (c) Taxes Generally * * * (d) Taxes of Shareholder Paid by Corporation * * * (e) Losses by Individuals.—Subject to the limitations provided in subsection (r) of this section, in the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—* * * (2) if incurred in any transaction entered into for profit, though not connected with

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the trade or business; * * * (j) Bad Debts * * * (k) Depreciation * * * (l) Depletion * * * (n) Charitable and Other Contributions.—In the case of an individual, contributions or gifts made within the taxable year to or for the use of: * * * (2) a corporation, or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual; * * * to an amount which * * * does not exceed 15 per centum of the taxpayer's *net income* as computed without the benefit of this subsection.

"Sec. 101. Capital Net Gains and Losses.—(a) Tax in Case of Capital Net Gain.—In the case of any taxpayer, other than a corporation, who for any taxable year derives a capital net gain
27 (as hereinafter defined in this section), there shall, at the election of the taxpayer, be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total tax shall be this amount plus 12½ per centum of the capital net gain.

"(b) Tax in Case of Capital Net Loss.—In the case of any taxpayer, other than a corporation, who for any taxable year sustains a capital net loss (as hereinafter defined in this section), there shall be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted, and the total tax shall be this amount minus 12½ per centum of the capital net loss; but in no case shall the tax of a taxpayer who has sustained a capital net loss be less than the tax computed without regard to the provisions of this section.

"(c) Definitions.—For the purposes of this title—

"(1) 'Capital gain' means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.

"(2) 'Capital loss' means deductible loss resulting from the sale or exchange of capital assets.

"(3) 'Capital deductions' means such deductions as are allowed by Section 23 for the purpose of computing net income, and are properly allocable to or chargeable against capital assets sold or exchanged during the taxable year.

"(4) 'Ordinary deductions' means the deductions allowed by Section 23 other than capital losses and capital deductions.

"(5) 'Capital net gain' means the excess of the total amount of capital gain over the sum of (A) the capital deductions and capital losses, plus (B) the amount, if any, by which the ordinary deductions exceed the gross income computed without including capital gains.

"(6) 'Capital net loss' means the excess of the sum of the capital losses plus the capital deductions over the total amount of capital gain.

"(7) 'Ordinary net income' means the *net income*, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions.

"(8) 'Capital assets' means property held by the taxpayer
28 for more than two years (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business. * * *." [Italics supplied.]

The Commissioner of Internal Revenue held in his construction of sections 23 (n) and 101 which, so far as this question is concerned, are the same as the related sections of the Revenue Acts of 1924, 1926, and 1928, that if a taxpayer sustained a capital net loss which by express provision of the statute could not be taken as a deduction in computing taxable net income, such capital net loss must nevertheless be deducted from the net income which the statute specified should be subjected to the normal and surtaxes imposed by sections 11 and 12 in arriving at the net income for the purpose of applying the 15 percent limitation prescribed by section 23 (n) on the deduction for charitable contributions. In the case at bar this method wiped out all of the taxpayer's income and showed a net loss of $59,958.46; however, for the purpose of the tax, plaintiff had a *net income* of $94,963.52. This method of determining whether the taxpayer is entitled to a deduction for charitable contributions is theoretical and we think it is not authorized by either the language or the intent of the statute. In the enactment of the provisions with reference to capital net gains and capital net losses Congress did not in any way evidence a purpose to take away or to limit the right of an individual taxpayer to deduct from net income, subject to tax, his charitable contributions in an amount not exceeding 15 percent of such net income. It would require language so clear as to leave room for no other reasonable construction in order to justify the belief that Congress intended that a loss which it specifically excluded and denied to a taxpayer as a deduction in determining the net income upon which he is required to pay a tax must, nevertheless, be deducted from such taxable net income for the purpose of determining whether he had a net income from which he could take a deduction for charitable contributions.

29 The capital net loss provisions were originally enacted in the Revenue Act of 1924. A capital net loss is the net loss sustained by a taxpayer in the sale of investment property held for more than two years. The statute provides two methods of computing the tax to be collected in the case of a taxpayer who has sustained a capital net loss and the method which will produce the higher tax must be followed under the plain mandate of the statute.

Section 101 (b) provides that the tax shall first be computed upon the basis of ordinary net income, which is determined without allowing any deduction in respect of the capital net loss, at the rates prescribed in other sections of the act and that the total tax due by the taxpayer shall be the tax thus determined less a credit against such tax of 12½ percent of the capital net loss. That section further provides that in no case shall the tax of a taxpayer who has sustained a capital net loss be less than the tax computed without regard to the provisions of that section. Under the first method of computing the net income and the tax, the capital net loss is *not allowed* as a deduction, but is used as a base for calculating the credit against the total tax. Under the second method, if it produces a higher tax, the capital net loss is, by the statute, made a *permissible deduction* in determining net income, and the tax upon such net income is computed at the rate specified in sections 11 and 12, and no credit against the resulting tax is made. This is the only instance where the statute authorizes a deduction of the capital net loss in determining taxable net income. In either case the taxpayer is taxed upon his "net income" as defined by the statute. Under the first method, in a case like the one under consideration, the Commissioner computes a tax upon a statutory *net income* but denies the taxpayer any deduction for charitable contributions. Under the second method the Commissioner likewise determines and computes the tax at the rates specified in the statute upon the statutory *net income* and allows the full deduction for charitable contributions to the extent of the limitation specified in section 23 (n). We can find no justification in the language of the statute for the denial of a deduction for charitable contributions under the first method. The statute is not ambiguous.

"Net income" is a statutory concept and in both of the cases
30 just mentioned the taxes are computed upon *net income* and it seems clear to us that in section 23 (n), relating to charitable contributions, the Congress did not use the term "net income" in any different sense. Deductions may be granted or withheld by Congress at its pleasure and when the statute denies to a taxpayer the right to take a certain deduction in determining his net income, such deduction may not be made in any case unless it is clearly authorized by the language of the statute or shown to be within the manifest intention of Congress, neither of which do we find in the present case. Moreover, Congress has specified the only instance in which a capital net loss is a permissible deduction in determining the statutory net income subject to tax and no other instance when such a loss may be deducted may be read into the statute by administrative or judicial construction, or upon any theory of supposed consistency. Consistency in theory is not necessary in matters of taxation and is not always found in taxing statutes. As was pointed out by the court in Helvering v. Bliss, 293 U. S. 144, a "capital net gain" is simply a part of the "net income" as defined by the statute and the mere fact that Congress chose to tax that part

of the net income at a fixed rate of 12½ percent, regardless of the amount thereof, made it none the less a part of the "net income"—that is, the base for the calculation of the tax to be paid by the taxpayer as contemplated and intended by the term "net income" as used in section 23 (n). By the same process of reasoning we think it is clear that since "net income" is always a statutory concept, a capital net loss, which is not a permissible or allowable deduction under section 23 in determining the net income of a taxpayer for the purpose of the tax imposed by sections 11 and 12—that is, the base for the calculation of the tax before deducting charitable contributions—may not be deducted from such net income for the purpose of denying altogether or materially reducing the deduction which Congress since October 3, 1917, has consistently given to individual taxpayers for charitable contributions. Any other construction would, we think, disregard legislative history of persuasive force with reference to the deduction of charitable contributions; it would adopt a distorted rather than the ordinary meaning of the language
31 of the several provisions of section 101, and would tend to
defeat rather than further the purpose of the act with reference to charitable contributions. In Howard Heinz v. Commissioner, 34 B. T. A. 885, the Board, at page 900, stated as follows:

"In the instant case it will be seen that the capital loss provision indirectly works to the petitioner's advantage, when read in conjunction with the provision for deducting charitable contributions, for while the former section [net loss section 101] limits the amount of losses to the petitioner's disadvantage, it increases the amount of his total net income, and to that extent, therefore, enlarges the charitable deduction which is measured by a percentage of that income. The ameliorative purpose of the two sections is therefore retained here. And there is nothing in the Bliss decision which warrants going farther."

The exclusion of the capital net loss as required by the statute without question serves to increase the amount of a taxpayer's total net income and, likewise, to increase his tax and to enlarge the base for the calculation of the deduction for charitable contributions which is limited to 15 percent of that net income. Charitable contributions to the extent of 15 percent of the net income subject to tax have been allowed by Congress as deductions from taxable net income—the base for the calculation of the tax—in every revenue act since the Act of 1916. If there were doubt as to the connotation of the term "net income," as used in section 23 (n), or another meaning other than net income subject to the tax imposed by sections 11 and 12 might be adopted, "the fact of its use in a tax statute would incline the scale to the construction most favorable to the taxpayer." Old Colony Railroad Co. v. Commissioner, 284 U. S. 552, 561. Beginning with section 214 (a) (10) of the Revenue Act of 1924 charitable contributions have been allowed as deductions from net income without

limitation where a taxpayer for the current taxable year, and in each of the preceding ten years has contributed to charity over 90 percent of his net income in each such year (after deducting income, war profits, and excess profits taxes paid). See section 214 (a) (10), Revenue Acts of 1924 and 1926, and section 120 of the Acts
32 of 1928 and 1932. In such case it is obvious that on no theory
could a capital net loss be deducted from ordinary net income for the purpose of reducing or entirely denying the deduction for the charitable contribution expressly given by the statute, and the defendant does not contend that under such circumstances the capital net loss could be deducted. Under the defendant's theory, a taxpayer who contributes over 90 percent of his annual net income to charity over a period of ten years is entitled, when he has a capital net loss, to deduct the whole amount of his contributions from ordinary net income undiminished by such loss, but a taxpayer who has contributed less than 90 percent of his net income to charity over a period of years and in the taxable year contributes a substantial amount, or even more than 90 percent to charity, may not, where the 15 percent limitation applies, obtain any deduction for such charitable contributions where the capital net loss exceeds the taxable net income, although such taxpayer is required by the statute to pay a substantial tax upon a definite statutory net income. It seems manifest that Congress did not intend such an unfair result, nor do we think it is required by the language of the statute. Charitable contributions are "ordinary deductions" under section 23 and in the case of a taxpayer having a capital net loss his *net income* as defined by section 23 (n) for the purpose of computing the allowable deduction for charitable contributions is "ordinary net income," which is the base for the calculation of the tax.

The fact that Congress provided in section 101 (b) that 12½ percent of a capital net loss should constitute a credit against the total tax computed upon the taxpayer's net income does not require the deduction in addition of the entire capital net loss from taxable net income for the purpose of measuring the amount upon which the deduction for charitable contributions shall be calculated. An amount so determined is nowhere mentioned or defined in the statute and it can never constitute the base for the calculation of the tax, except when the deduction of the capital net loss in its entirety from ordinary net income produces a greater tax. In such case the difference between the ordinary net income and the capital net
33 loss is the statutory "net income"—the base for the calculation
of the tax—from which the deduction of the charitable contributions within the limit specified is to be made. Had Congress intended that this method be followed in every instance in determining the net income to be used as the base for the calculation of the 15 percent limitation for charitable contributions, we think it would have used language sufficiently clear not to be misunderstood. In the

Revenue Act of 1924 Congress enacted new provisions with reference to charitable contributions and capital net losses. With respect to the former it enlarged the deduction so as to encourage such contributions, and with respect to the latter it limited the right of the taxpayer to deduct a capital net loss. We think, also, that if Congress had intended that the net income should be taxed at the rates specified in sections 11 and 12, but reduced in amount for the purpose of calculation of the 15 percent limitation on the deduction of charitable contributions because a credit of 12½ percent of the capital net loss was allowed as a credit against the resultant tax, some provision for such reduction would have been made. When a taxpayer has a capital net loss his statutory net income is his "ordinary net income" and this is made clear by section 101 (c) (7). The Board of Tax Appeals so held in Elkins v. Commissioner, 24 B. T. A. 572 (decided November 3, 1931), and Livingood, Executor of Emery, v. Commissioner, 25 B. T. A. 585 (decided February 23, 1932). In our opinion these decisions were correct. In Helvering v. Bliss, supra, the Supreme Court said:

"If the meaning of the act were doubtful, we should still reach the same conclusion. The exemption of income devoted to charity and the reduction of the rate of tax on capital gains were liberalizations of the law in the taxpayer's favor, were begotten from motives of public policy, and are not to be narrowly construed."

The force of that statement when applied to the instant case is apparent. The liberalization of the law in the taxpayer's favor by permitting him to deduct charitable contributions to the extent of 15 percent of his net income subject to tax as determined before any allowance for charitable contributions is not to be narrowly construed. We have had occasion heretofore to point out that the benefi-
34 cent provisions of remedial statutes are not to be thwarted by nice technicalities not within the minds of the legislators. Siegel v. United States, 84 C. Cls. 551. Under these circumstances we should not depart from the plain and ordinary meaning of section 23 (a) in an effort to bring about a uniformity by deducting capital net losses from statutory net income if capital net gains are to be treated as a part of the statutory net income, which uniformity it is claimed Congress intended but failed to express. We are of opinion that the term "net income," as used in section 23 (n), was used in the same sense in which it has always been used in other statutes since the Revenue Act of 1916, and, as we shall hereinafter attempt to show, we think this interpretation is consistent with all the provisions of section 101.

The Revenue Act of October 3, 1917 (H. R. 4280), ch. 63, 65 Stat. 301, 330, as it was passed by the House of Representatives, contained no provision with reference to deductions for charitable contributions. The bill was amended by the Senate and "Title XII—Income Tax Amendments" was inserted and in section 1201 (2) thereof,

section 5 of the Revenue Act of 1916 was amended so as to provide for a deduction by individuals of charitable contributions to the extent of "15 percent of the taxpayer's *taxable* net income as computed without the benefit of this paragraph." [Italics supplied.] See Conference Report on the Revenue Act of 1917, Senate Document 115, 65th Congress, First Session, p. 2. In section 214 (a) (11) of the Revenue Act of 1918 approved February 24, 1919, 40 Stat. 1057, 1066–1068, relating to deductions for charitable contributions, and corresponding sections of all subsequent revenue acts, the word "taxable," as used in section 1201, supra, of the Revenue Act of 1917 was left out for the obvious reason, it seems to us, that the word was surplusage and that "the taxpayer's net income," as used in such later acts, meant and was intended to mean "the taxpayer's taxable net income." The provision for the deduction of charitable contributions was consistently so construed until the capital net loss provisions of section 208 of the Revenue Act of 1924 were enacted. In our opinion section 208, which denied a deduction of a capital net loss in determining the taxpayer's taxable net income,
35 did not and was not intended to change the original meaning of the words "the taxpayer's net income" as used in the section relating to the deduction for charitable contributions.

There is nothing in the history of the legislation denying the deduction of a capital net loss in the determination of taxable net income showing any intent on the part of Congress to reduce or take away the deduction for charitable contributions. The history of the legislation with reference to deductions for charitable contributions clearly shows that Congress over a long period of years has intended that this deduction should be allowed whenever an individual taxpayer has a statutory net income upon which a tax is to be computed and collected, and that such deduction is to be taken from that net income. The capital net loss provision was enacted by reason of the practice of many taxpayers when they had a large ordinary net income to sell investment property on which a loss instead of a gain would be realized with the view to reducing taxes by offsetting such capital net losses against gross income from all sources. As a result the Government was being deprived of revenue because capital net gains were taxable only at 12½ percent regardless of the amount and capital net losses were deductible prior to 1924 from ordinary gross income in their entirety. Neither the statutes nor the committee reports contain any suggestion that the deduction for charitable contributions was to be altered or disturbed through the medium of the capital net loss provision. The declared purpose of the Congress in permitting a deduction for charitable contributions over a long period of years was to encourage such donations. Such deduction for donations necessarily served to reduce taxable income and, hence, to reduce taxes prior to the enactment of the net loss provisions, but such deductions were allowed from motives of public policy.

For the reasons hereinbefore stated, we are unable to concur in the decisions in Lockhart v. Commissioner, 32 B. T. A. 732 (decided June 10, 1935), affirmed (C. C. A., 3rd Circ.), 89 Fed. (2d) 143; Avery v. Commissioner, 32 B. T. A. 948 (decided July 16, 1935), affirmed (C. C. A., 7th Circ.), 84 Fed. (2d) 905; Heinz v. Commis-

sioner (decided August 7, 1936), affirmed (C. C. A., 3rd Circ.),
36 94 Fed. (2d) 832; Nippert, et al. v. Commissioner, 32 B. T. A. 892; Hill v. Commissioner, 33 B. T. A. 891; Zimmermann, et al. v. Commissioner, 36 B. T. A. 279; Wollman v. Commissioner, and Johnston v. Commissioner, decided by memorandum opinions in February 1936 and April 1937, respectively, all on the authority of Lockhart v. Commissioner, supra, and G. C. M. 14030, XIII-2 C. B. 135. The facts stipulated in the Heinz and Lockhart cases are confusing. In the former the taxpayer stipulated that his taxable net income for 1931, as reflected in the deficiency notice, was $186,879.09, when, as a matter of fact, his true taxable net income was his "ordinary net income" of $375,844.65 and a like stipulation of fact was made with reference to the year 1932. In the latter case it was stipulated that the taxable net income for 1929 was $911,599.10, whereas the true taxable net income was the ordinary net income of $966,467.20. It seems clear that the Commissioner cannot treat a capital net loss as a part of the taxable net income. All of the decisions mentioned, beginning with the case of Lockhart v. Commissioner, supra, held that a capital net loss, although not a permissible deduction under section 23 for the purpose of determining net income subject to the tax imposed by sections 11 and 12, might, nevertheless, be deducted from such net income for the purpose of determining the amount on which the 15 percent limitation for charitable contributions was to be computed on the ground that this conclusion was required by the opinion of the Supreme Court in Helvering v. Bliss, supra. In the Lockhart case the Board of Tax Appeals and the Circuit Court of Appeals for the 3rd Circuit appear to have attached considerable importance to footnote 2 to the opinion of the Supreme Court in the Bliss case, p. 146; but that footnote was not inserted as a part of the opinion of the court to the effect that a capital net gain was a part of the statutory net income—the base for the calculation of the tax—nor did it follow any reference in the opinion of the court to the capital net loss provisions. This footnote followed the statement of facts involved in the case before the court, and specifically the concluding sentence in such statement that "the Board of Tax Appeals sustained the Commissioner [holding that a capital net gain was not a part of the net income within the meaning of section
37 (23 (n)], but the Circuit Court of Appeals, by a divided court, reversed the Board." We do not think that the reference in that footnote to the decisions of the Board in Elkins v. Commissioner, supra, and Livingood v. Commissioner, supra, was either a holding by the court that those decisions, which involved a capital net loss, were erroneous or that they had been overruled by the Board in Straus v. Commissioner, 27 B. T. A. 1116. In the Straus case the Board specifically stated that it was not passing upon the question whether its decision in that case affected in any way its previous holdings in the Elkins and Livingood cases.

The Board and the Circuit Court of Appeals in the Lockhart and Heinz cases held that under the decision of the Supreme Court in the Bliss case net income as defined by section 21, and computed under sections 22 and 23, not only includes capital gains, but is to be determined after the deduction of capital losses, since the latter are losses deductible from gross income under section 23 (e). The

reasons which we have hereinbefore mentioned lead us to the conclusion that capital net losses are not deductible under section 23 (e) for any purpose, except when the allowance of a capital net loss as an ordinary deduction would produce a higher tax than its exclusion as a deduction and an allowance of 12½ percent against the resulting tax upon net income otherwise determined. Piper v. Willcuts, 64 Fed. (2) 813; Hoffman v. Commissioner, 71 Fed. (2) 929. The fact that under the broad language of section 23 (e) a capital net loss would be deductible if it were not excluded, does not, in our opinion, require such capital net loss to be deducted from ordinary gross income to determine whether a taxpayer has a statutory net income for the purpose of deductions for charitable contributions. Cf. Massachusetts Mutual Life Insurance Co. v. United States, 75 C. Cls., 117, 126, affirmed 288 U. S., 269. Compare section 23 (r), Revenue Act of 1932. Net losses on stocks, bonds, or other securities not capital assets were denied as deductions in the taxable year in which sustained for the same reason that capital net losses were denied as deductions, namely, to prevent a taxpayer from
38 avoiding the normal and surtaxes by selling stocks and bonds on which he could sustain loss in a taxable year in which he had a large income from other sources.

The Circuit Court of Appeals for the Second Circuit in Bliss v. Commissioner, 68 Fed. (2d) 890, 892, which involved capital net gains for 1928 and 1929, stated, in holding that a capital net gain was a part of the net income upon which the deduction for charitable contributions should be computed, that a capital net loss would be deductible without exception from ordinary net income in determining the taxpayer's net income for the purpose of deduction for charitable contributions; and in White v. Atkins, 69 Fed. (2d) 960, 963, which also involved a capital net gain for 1929, the Circuit Court of Appeals for the First Circuit held without exception that a capital net loss was deductible from ordinary net income in determining the taxpayer's net income for the purpose of deduction for charitable contributions and expressly overruled the decisions of the Board of Tax Appeals in Elkins v. Commissioner, supra, and Livingood v. Commissioner, supra. The Bliss and White cases, supra, did not involve a capital net loss and, for the reasons hereinbefore stated, we are unable to concur in the views expressed as to the proper method to be employed in determining the taxpayer's net income for the purpose of deduction for charitable contributions where such taxpayer had a capital net loss for the taxable year.

We do not interpret the opinion of the Supreme Court in the Bliss case as it has been interpreted by the Board of Tax Appeals and the Circuit Courts of Appeals in the cases hereinbefore cited. The question of whether a capital net loss should be deducted from the taxpayer's taxable net income in fixing a net income different from the taxable net income for the purpose of calculating the amount of the allowable deduction for charitable contributions does not appear to have been considered or decided by the court. Webster v. Fall, 266 U. S. 507, 511; United States v. Anderson, et al., 269 U. S. 422, 442;

United States v. Mitchell, 271 U. S. 9, 14. However, we think the decision in Helvering v. Bliss, supra, lends greater supp'rt to the position of the plaintiff in this case than to that of the defendant.

The court in holding that a "capital net gain" taxed at the
39 special rate of 12½ percent was a part of the "net income"
within the meaning of that term, as used in section 23 (n), said, at page 147:

"The scheme of all the Revenue Acts since that of 1916 has been to sweep all income of every sort, including capital gains, into what is denominated gross income and to authorize certain deductions therefrom in order to arrive at net income—*the base for calculation of the tax.* In the Act of October 3, 1917, Congress, in order to encourage gifts to religious, educational, and other charitable objects, granted the privilege of deducting such gifts from gross income, but limited the total deduction to 15 per cent of the taxpayer's net income, calculated in the first instance without reference to the amount of such contributions. All of the later Acts have contained a like provision. The Acts provide that the taxpayer shall first deduct from gross income the total of all permissible deductions save that for contributions, thus arriving at a provisional net income, and then deduct therefrom his contributions, but in no event to an amount greater than fifteen per cent of the provisional net income. By the last mentioned operation the final net income—*the base for calculation of the tax*—is ascertained. The relevant sections of the Act of 1928 are typical. They are copied in the margin." [Italics supplied.]

It will thus be seen that the court definitely held that charitable contributions were deductible in arriving at the base for the calculation of the tax—the statutory net income. In that way taxable income, to the amount of the deductible contributions, is free from tax, and the beneficent purpose of section 23 (n) is made effective. In the instant case the defendant determined the base for the calculation of the tax to be $94,963.52 but refused to permit plaintiff to take a deduction for contributions in arriving at that base, notwithstanding plaintiff's *final net income* within the language of the court in the Bliss case was $94,963.52—the base for the calculation of the tax—and was so employed by the Commissioner of Internal Revenue. The Court, at pages 148–150, further said:

"Commencing with the Revenue Act of 1921 Congress, in order to encourage realization of profits on capital assets, saw fit to relieve gain thus derived of the heavy surtaxes then applicable, and to permit the payment of tax at a flat rate of 12½ per cent on so
40 much of the taxpayer's income as represented the net gain from
capital transactions.

"The accomplishment of this purpose of applying two rates to *two different kinds of net income* required new provisions as to the base for each rate. Section 101 of the Revenue Act of 1928 prescribes the method to be followed. So far as material it is set forth in the margin. In extending this relief to taxpayers, Congress might have

modified the privilege theretofore existing with respect to charitable contributions, by directing that they should be deducted solely from capital net gain or should be apportioned and deducted ratably from ordinary net income and from capital net gain. The Acts, however, evince no such purpose. In the Act of 1928, as will be seen by reference to Sections 21, 22, and 23 (supra note 4), the statutory concept of net income is preserved. These sections are found in part II of title I, which deals with 'Computation of Net Income.' Section 101, on the other hand, is found under 'Supplemental Provisions,' and is captioned 'Supplement A—Rates of Tax.' *It is obviously directed to the matter of computation of tax on a portion of net income as defined in Section 21. There is nothing novel in such a division of the statutory net income into parts for the purpose of applying different rates of tax*, as witness the provisions fixing the rates on those portions of the entire net income attributable to dividends, earned income, interest on United States obligations, and gains from the sale of mines, and allowing credits for dependents." [Italics supplied.]

The two kinds of net income which existed in the Bliss case consisted of (1) "ordinary net income," which was gross income as defined by section 22 other than gains derived from the sale of capital assets less the deductions allowed by section 23, among which was included charitable contributions, but from which was excluded capital deductions and capital net losses, and (2) "capital net gain," which was the balance of the gross income as defined by section 22 in excess of capital deductions and capital losses. In the case at bar we have only one net income, i. e., "ordinary net income." Under the provisions of the statute, including the provisions with reference to capital net gains and capital net losses, if the ordinary deductions allowed by section 23 exceed that part of gross income to be used in computing "ordinary net income," the excess of such ordinary
41 deductions is by express provision of the statute (section 101 (c) (5)) to be carried over and deducted from the capital net gain, and the balance of the capital net gain, if any, is the taxpayer's *statutory net income* for the purpose of the tax. In that case there would be no normal or surtaxes and the tax due would be the capital gains tax of 12½ percent regardless of the amount of the "net income." But when the gross income to be used for the purpose of computing the "ordinary net income" is greater than the "ordinary deductions" allowed by section 23, including charitable contributions, and the capital deductions and capital losses under section 101 exceed that part of the gross income to be used in computing the capital gains, the statute stops without authorizing any carrying over of the capital net loss as a deduction from "ordinary net income" and directs that the tax imposed by sections 11 and 12 be computed upon that net income, except when to carry over and deduct such capital net loss from ordinary net income a greater normal and surtax, less a 12½ percent credit, would result. From this it seems to us plain enough that under the express pro-

visions of the entire statute a taxpayer, although he has a capital net loss and, also, has an ordinary net income which produces a higher tax under sections 11 and 12 less the credit of 12½ percent capital net loss, is in the same situation so far as a deduction for charitable contributions is concerned as the taxpayer who has no capital gains, capital deductions, or capital losses. As we shall hereinafter show, the statute specifically permits a deduction from capital net gain of the excess of the ordinary deductions over ordinary gross income, while a capital net loss is denied, in a case like the one at bar, as a deduction from ordinary gross or net income.

In the Bliss case the court did not decide that if a taxpayer had only one kind of net income and paid a tax on that net income his deduction for contributions was to be reduced or denied altogether as happened in the case at bar. The court simply held that ordinary net income and capital net gains were portions of the *entire net taxable income* and that they were separated for the purpose of applying different rates of tax. A capital net gain was held to be a portion of the net income as defined by section 21. Similarly "ordi-
42 nary net income" is a portion of the net income as defined by section 21, and, by express provision of the statute, it may not be reduced by a capital net loss. Section 101 (c) (7) provides that "'Ordinary net income' means the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions." It will therefore be seen that ordinary net income is "net income" computed in accordance with sections 21, 22, and 23 for the reason that those sections define net income and are a part of "this title" referred to in section 101 (c) (7) which has reference to Title I, Income Tax. In the Bliss case, supra, the court further said, at page 150:

"The plain requirements of Section 101 are that in ascertaining ordinary net income there shall be excluded from the computation only items of capital gain, capital loss, and capital deductions. Charitable contributions covered by Section 23 (n) obviously are not capital deductions as defined by Section 101 (c) (3), but on the contrary are "ordinary deductions" within the meaning of Section 101 (c) (4).

"By the express words of Section 23 (n) charitable contributions are to be deducted to ascertain net income as defined in Section 21; and nothing in Section 101, which prescribes merely a method for segregating a portion of that net income for taxation at a special rate, in any wise alters the right of the taxpayer to take the deduction in accordance with Section 23 (n)."

In the first paragraph above, the court pointed out that when section 101 controls the computation of the tax, ordinary net income is ascertained by excluding a capital net gain or capital net loss. The exclusion applies to both. A capital net gain is not included in ordinary net income but it is, nevertheless, net income and is taxed as such. If a capital net gain were included in ordinary net income,

section 101 would conflict with sections 11 and 12. It does not necessarily follow from the fact that a capital net gain (although excluded in computing ordinary net income subject to the normal and surtaxes) is a part of the statutory "net income" because it is a gain and is taxed at 12½ percent instead of at the rates specified in sections 11 and 12, that a capital net loss (which is specifically excluded in the determination whether the taxpayer otherwise
43 has a taxable net income) must be deducted from the only taxable statutory net income the taxpayer has for the purpose of reducing or denying altogether the taxpayer's charitable contributions. As hereinabove pointed out, the last clause of section 101 (b) specifies the only instance when a capital net loss may be deducted from ordinary net income. It is to be deducted when such deduction will produce a greater tax than the tax (less the 12½ percent credit) computed upon the ordinary net income less the charitable contributions. The Supreme Court specifically held in the Bliss case that charitable contributions are ordinary deductions within the meaning of section 101 (c) (4) and are properly deductible in ascertaining ordinary net income. The word "excluding" appearing in section 101 (c) (7) does not contemplate exclusion of the ordinary deductions for charitable contributions. The plain language of section 101 (c) is that ordinary net income, as defined by section 101 (c) (7), as applied to a case involving a capital net gain or a capital net loss, is to be ascertained by the same process. We think Congress did not intend to discriminate between taxpayers having capital net gains or capital net losses in the method to be employed in determining "ordinary net income" for the application of normal and surtaxes as prescribed and imposed by sections 11 and 12. The ordinary deduction for charitable contributions was preserved in both cases. It was specifically pointed out in the Bliss decision at page 150 that "nothing in section 101 * * * in any wise alters the right of the taxpayer to take the deduction in accordance with section 23 (n)." The statute requires the deduction for charitable contributions to be taken as a whole from ordinary net income. This applies whether the case is one involving capital net gain or capital net loss. The only instance in which the deduction for charitable contributions is not taken as a whole from "ordinary net income," either under section 23 (n) or section 120, is where there is an excess of ordinary deductions, including the deduction for contributions, over the gross income computed without including capital gains, as was the case in Straus v. Commissioner, supra. In such a case the excess is subtracted in arriving at the capital net gain subject to the 12½ percent
44 tax. Section 101 (c) (5) expressly so provides. See, also, Ways and Means Committee Report on the Revenue Bill of 1924, No. 179, page 19, 68th Congress, 1st Session, which points out that when the ordinary deductions exceed the ordinary gross income, the excess serves to reduce the amount of the capital net gain.

If we read into any of the sections of the statutes directing how net income must be determined an implied condition that a capital

net loss must be deducted as an ordinary deduction for the purpose of determining "the taxpayer's net income" upon which he may compute his allowable deduction for charitable contributions, we are forced by the provisions of section 101 to ignore such implied condition when we come to determine the taxpayer's taxable net income for the purpose of normal and surtaxes. If we imply such condition in dealing with charitable contributions we violate, it seems to us, the well-established rule against legislation by construction and run counter to the originally expressed and subsequently intended direction of Congress that charitable contributions are to be deducted from "the taxpayer's taxable net income."

Where there is a capital net gain, such gain is a part or all of the taxpayer's statutory net income, but where there is a capital net loss the ordinary net income is the taxpayer's entire statutory net income. Judgment will be entered in favor of plaintiff for $969.79 with interest as provided by law. It is so ordered.

Williams, Judge; Green, Judge; and Booth, Chief Justice, concur.

Whaley, Judge, concurs in the result.

45 V. *Judgment*

At a Court of Claims held at the City of Washington on the 4th day of April, A. D. 1938, judgment was ordered to be entered as follows:

Upon the special findings of fact, which are made a part of the judgment herein, the court decides, as a conclusion of law, that the plaintiff is entitled to recover.

It is therefore adjudged and ordered that the plaintiff recover of and from the United States nine hundred sixty-nine dollars and seventy-nine cents ($969.79) with interest at the rate of six percent per annum from May 12, 1934, to such date as the Commissioner of Internal Revenue may determine in accordance with the provisions of section 177 (b) of the Judicial Code, being a part of the Revenue Act of 1928.

46 Court of Claims of the United States

No. 43278

Frederick Pleasants

vs.

The United States

[Clerk's certificate to foregoing transcript omitted in printing.]

[Endorsement on cover:] File No. 42,654. Court of Claims. Term No. 169. The United States, Petitioner, vs. Frederick Pleasants. Petition for a writ of certiorari and exhibit thereto. Filed July 1, 1938. Term No. 169 O. T. 1938.

U. S. GOVERNMENT PRINTING OFFICE: 1938

30 Supreme Court of the United States

Order allowing certiorari

Filed October 10, 1938

The petition herein for a writ of certiorari to the Court of Claims is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

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U. S. GOVERNMENT PRINTING OFFICE: 1938

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In the Supreme Court of the United States

OCTOBER TERM, 1938

No. —

THE UNITED STATES, PETITIONER

v.

FREDERICK PLEASANTS

PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS

The Solicitor General, on behalf of the United States, prays that a writ of certiorari issue to review the judgment of the Court of Claims entered in the above-entitled cause.

OPINION BELOW

The opinion of the Court of Claims was entered April 4, 1938, and is reported in 22 F. Supp. 964.

JURISDICTION

The judgment of the Court of Claims was entered April 4, 1938. The jurisdiction of this Court is invoked under Section 3 (b) of the Act of February 13, 1925.

QUESTION PRESENTED

Whether the Court of Claims erred in holding that, in computing a taxpayer's net income under Section 23 (n) of the Revenue Act of 1932 as the base of which 15 per cent is allowable for charitable deductions, a capital net loss should be disregarded.

STATUTE INVOLVED

The applicable portions of the Revenue Act of 1932 will be found in the Appendix, *infra*, pp. 11–14.

STATEMENT

The special findings of fact of the Court of Claims may be summarized as follows:

Respondent duly filed his individual income tax return for the year 1932 on March 15, 1933, showing a total tax of $161.77, which was paid on the same date. On this return respondent reported a total income of $99,123.31, consisting of salaries, interest, and dividends, and total deductions of $5,235.15, consisting of taxes paid, losses by fire, storm, etc., and contributions to charitable organizations. He also reported a capital net loss of $157,642.62. (Fdg. 1.)

As a result of an audit of respondent's books and records the Commissioner of Internal Revenue determined that there was an additional tax due from the respondent in the amount of $908.92, and so notified respondent on April 13, 1934. The deficiency in tax of $908.92, together with interest

of $60.87, aggregating $969.79, was thereafter assessed and, upon demand, the same was paid on May 12, 1934. (Fdgs. 3, 4.)

In arriving at the deficiency in tax the following adjustments were made: (1) Gross income was reduced to $96,702.67 from $99,123.31. (2) The total deductions claimed on the return were reduced to $1,739.15 from $5,235.15. This reduction was caused by the disallowance of the charitable deductions on the ground that since the ordinary net income reduced by the capital net loss resulted in a net loss for the year, there was no income against which to apply the 15 percent deduction for charitable contributions under Section 23 (n) of the Revenue Act of 1932. (3) Capital net loss was reduced to $154,921.98 from $157,642.62. (Fdg. 3.)

On May 19, 1934, respondent duly filed a claim for refund for $969.79 for 1932 upon the ground that the amount of $3,496 representing charitable contributions, being less than 15 percent of his taxable net income, was a proper and legal deduction. This claim was rejected on January 17, 1935. (Fdg. 5.) This suit was filed in the Court of Claims March 6, 1936.

On April 4, 1938, the Court of Claims rendered an opinion in favor of respondent and entered judgment in the amount of $969.79, together with interest from May 12, 1934.

SPECIFICATION OF ERRORS TO BE URGED

The court below erred:

1. In holding that capital net losses are not deductible from gross income in arriving at the "net income" under Section 23 (n), Revenue Act of 1932.

2. In holding that the "net income" to be used as the base for the computation of the 15 percent deduction for charitable contributions is to be computed without taking into account a capital net loss sustained by the taxpayer, where the tax as computed under the provisions of Section 101, Revenue Act of 1932, is larger than the tax computed without regard to the provisions of that section.

3. In failing to hold that since the respondent's capital net loss exceeded his ordinary net income as computed without any adjustment for such capital net loss, there was no "net income" within the meaning of Section 23 (n), Revenue Act of 1932.

4. In failing to enter judgment for the United States and dismiss the petition.

REASONS FOR GRANTING THE WRIT

The Court of Claims has held in the present case that in computing the taxpayer's "net income" specified in Section 23 (n) as the measure of which 15 per cent may be allowed for charitable deductions, a capital net loss may not be taken into account. Respondent had an "ordinary" net income, i. e., income exclusive of capital gains and

capital losses, in the amount of $94,963.52. He had a capital net loss of $154,921.98. The Commissioner of Internal Revenue determined that respondent had no "net income" within the meaning of Section 23 (n) and hence was entitled to no deduction for charitable contributions. The Court of Claims held, however, that he was entitled to such a deduction in an amount not in excess of 15 per cent of $94,963.52.

1. The decision of the Court of Claims is in direct conflict with the decisions of two Circuit Courts of Appeals. *Avery* v. *Commissioner*, 84 F. (2d) 905 (C. C. A. 7th), certiorari denied, 299 U. S. 604, rehearing denied, 300 U. S. 686; *Lockhart* v. *Commissioner*, 89 F. (2d) 143 (C. C. A. 3d), certiorari denied, 302 U. S. 711; *Heinz* v. *Commissioner*, 94 F. (2d) 832 (C. C. A. 3d). It is in conflict also with the decisions of the Board of Tax Appeals. *Nippert* v. *Commissioner*, 32 B. T. A. 892; *Hill* v. *Commissioner*, 33 B. T. A. 891, affirmed on another ground, 88 F. (2d) 941 (C. C. A. 8th); *Zimmerman* v. *Commissioner*, 36 B. T. A. 618, pending on appeal in the Circuit Court of Appeals for the Third Circuit. It is at variance with the opinion in *Bliss* v. *Commissioner*, 68 F. (2d) 890, 892 (C. C. A. 2d), affirmed, 293 U. S. 144. The Court of Claims stated in its opinion herein that it is "unable to concur in the decisions" of the Third and Seventh Circuit Courts of Appeals and the Board of Tax Appeals. Following the decision of this Court in *Helvering* v. *Bliss*, 293 U. S.

144, the decisions of the Board and the lower courts have been uniformly opposed to the holding of the court below.

2. The decision is in substantial conflict with the decision of this Court in *Helvering* v. *Bliss*, just cited. That case presented the question whether in computing the "net income" to be used as a base for the measurement of allowable charitable deductions under Section 23 (n), a capital net gain was to be included as part of the net income. It was argued that Section 101 (a), which provides a method for segregating capital net gain and taxing it at a special rate, required the exclusion of capital net gain from the computation of net income under Section 23 (n). This Court rejected that argument, holding that nothing in Section 101 (a) affected the definition of net income in Section 23 (n), that the definition of "net income" clearly contemplated the inclusion of income of every sort, including capital gains, with a deduction for capital losses, and that the special method and rate of tax provided by Section 101 did not affect the content of net income within the meaning of Section 23 (n).

The present case involves a capital net loss, instead of a capital net gain, and the special method and rate of tax thereon are prescribed in Section 101 (b) instead of Section 101 (a), but the reasoning and conclusion of the *Bliss* case are equally applicable here. Section 23 (n) provides that the 15 per cent limitation on charitable deductions

shall be measured by "net income." That term is defined (Sec. 21) to mean "gross income computed under section 22, less the deductions allowed by section 23." Gross income under Section 22 clearly includes capital gains, and the deductions allowed by Section 23, specifically losses incurred in trade or business or in any transaction entered into for profit, clearly include capital losses.[1] Hence the fact that capital net losses (that is, capital losses minus capital gains and capital deductions) are segregated by Section 101 (b) for the purpose of computing a separate tax does not justify their being ignored in determining the base upon which to compute the 15 per cent limitation for charitable contributions, any more than the segregation of capital net gains for computing a separate tax justified ignoring them for computation of the 15 per cent limitation in the *Bliss* case.

The decision below substitutes for "net income" as used in Section 23 (n) "ordinary net income," used in Section 101 and defined (Sec. 101 (c) (7)) as "net income, computed in accordance with the provisions of this title, after excluding all items of

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[1] If there were any doubt that Section 23 referred to capital losses, it would be removed by Section 101 (c) (4) of the Act, which provides that for the capital net loss determination the term "ordinary deductions" means "the deductions allowed by section 23 other than capital losses and capital deductions." There would be no necessity for the addition of the words "other than capital losses and capital deductions" if those items were not included in Section 23.

capital gain, capital loss, and capital deductions." It was precisely this view which was rejected by the Court in the *Bliss* case, where it was said (293 U. S. at 146–147):

> For "net income," the base specified in § 23 (n) upon which the 15 per cent. deduction of charitable contributions is to be calculated, the petitioner would substitute "ordinary net income" as defined in § 101. So to read the Act would violate its plain terms and run counter to the history of the legislation.

Indeed, the opinion in the *Bliss* case appears to assume that the decision therein is controlling in cases of capital net loss. The Court cited with evident approval (p. 151, note 8) the ruling in I. T. 2104, III–2 Cumulative Bulletin 152, which held that capital net losses should not be excluded in computing the net income upon which the 15 per cent limitation for contributions is measured. In addition, this Court apparently accepted the decision of the Board in a capital net gain case, *Straus* v. *Commissioner* 27 B. T. A. 1116, as a reversal of the Board's prior position not only with respect to capital net gains (*Harbison* v. *Commissioner,* 26 B. T. A. 896; *Bliss* v. *Commissioner,* 27 B. T. A. 896; *Colgate* v. *Commissioner,* 27 B. T. A. 506), but also with respect to capital net losses (*Elkins* v. *Commissioner,* 24 B. T. A. 572; *Livingood* v. *Commissioner,* 25 B. T. A. 585). See 293 U. S. at 146, note 2.

It is true that the Government's position in the present case, involving a reduction in the base for measuring the limit of charitable contributions, works to the disadvantage of the taxpayer, while the holding in the *Bliss* case worked to the taxpayer's advantage. This result was expressly adverted to by the Court of Appeals in the *Bliss* case, and was deemed to fortify its conclusion, since it enabled the court to put aside in that case any rule of interpretation requiring exemptions to be narrowly construed (68 F. (2d) at 892). In other applications as well, it has been recognized that the introduction of the capital net gains provisions was meant to be favorable to the taxpayer, and the capital net loss provisions favorable to the Government. See *Piper* v. *Willcuts*, 64 F. (2d) 813, 815–816 (C. C. A. 8th).

3. The question involved is one of importance in the administration of the Federal income tax laws. The same or similar provisions with respect to capital losses appear in the Revenue Acts of 1924, 1926, 1928, and 1932. Beginning with the Revenue Act of 1934 a radical change was made in the method of treating capital gains and losses, so that this question will not arise under the later Acts; there are, however, at least eighteen cases now pending in the Board of Tax Appeals, involving approximately $500,000, which present the same question as that herein, two appeals pending in the Third and Eighth Circuit Courts of Ap-

peals, and, we are informed by the Chief Counsel, Bureau of Internal Revenue, a considerable number of similar cases pending before the Income Tax Unit of the Bureau. The question is, therefore, one of present importance calling for review by this Court.

Wherefore, it is respectfully submitted that this petition for a writ of certiorari to review the judgment of the Court of Claims should be granted.

ROBERT H. JACKSON,
Solicitor General.

JUNE 1938.

APPENDIX

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 11. NORMAL TAX ON INDIVIDUALS.

There shall be levied, collected, and paid for each taxable year upon the net income of every individual a normal tax equal to the sum of the following:

* * * * *

SEC. 12. SURTAX ON INDIVIDUALS.

(a) *Rates of surtax.*—There shall be levied, collected, and paid for each taxable year upon the net income of every individual a surtax as follows:

* * * * *

SEC. 21. NET INCOME.

"Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(e) *Losses by individuals.*—Subject to the limitations provided in subsection (r) of this section, in the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or

(3) of property not connected with the trade or business, if the loss arises from fires, storms, shipwreck, or other casualty, or from theft. No loss shall be allowed as a deduction under this paragraph if at the

time of the filing of the return such loss has been claimed as a deduction for estate tax purposes in the estate tax return.

* * * * *

(n) *Charitable and other contributions.*—In the case of an individual, contributions or gifts made within the taxable year to or for the use of: * * * to an amount which in all the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this subsection. Such contributions or gifts shall be allowable as deductions only if verified under rules and regulations prescribed by the Commissioner, with the approval of the Secretary * * *.

* * * * *

SEC. 101. CAPITAL NET GAINS AND LOSSES.

(a) *Tax in case of capital net gain.*—In the case of any taxpayer, other than a corporation, who for any taxable year derives a capital net gain (as hereinafter defined in this section), there shall, at the election of the taxpayer, be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: A partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total tax shall be this amount plus 12½ per centum of the capital net gain.

(b) *Tax in case of capital net loss.*—In the case of any taxpayer, other than a corporation, who for any taxable year sustains a capital net loss (as hereinafter defined in this section), there shall be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the

basis of the ordinary net income at the rates and in the manner as if this section had not been enacted, and the total tax shall be this amount minus $12\frac{1}{2}$ per centum of the capital net loss; but in no case shall the tax of a taxpayer who has sustained a capital net loss be less than the tax computed without regard to the provisions of this section.

(c) *Definitions.*—For the purposes of this title—

(1) "Capital gain" means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.

(2) "Capital loss" means deductible loss resulting from the sale or exchange of capital assets.

(3) "Capital deductions" means such deductions as are allowed by section 23 for the purpose of computing net income, and are properly allocable to or chargeable against capital assets sold or exchanged during the taxable year.

(4) "Ordinary deductions" means the deductions allowed by section 23 other than capital losses and capital deductions.

(5) "Capital net gain" means the excess of the total amount of capital gain over the sum of (A) the capital deductions and capital losses, plus (B) the amount, if any, by which the ordinary deductions exceed the gross income computed without including capital gains.

(6) "Capital net loss" means the excess of the sum of the capital losses plus the capital deductions over the total amount of capital gain.

(7) "Ordinary net income" means the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss and capital deductions.

(8) "Capital assets" means property held by the taxpayer for more than two years (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business. * * *

U. S. GOVERNMENT PRINTING OFFICE: 1933

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CITATIONS

In the Supreme Court of the United States

October Term, 1938

No. 169

The United States, petitioner

v.

Frederick Pleasants

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS

BRIEF FOR THE UNITED STATES

OPINION BELOW

The opinion of the Court of Claims (R. 14–29) is reported in 22 F. Supp. 964.

JURISDICTION

The judgment of the Court of Claims was entered April 4, 1938 (R. 29). The petition for writ of certiorari was filed July 1, 1938 (R. 29), and was granted October 10, 1938. The jurisdiction of this Court is invoked under Section 3 (b) of the Act of February 13, 1925.

QUESTION PRESENTED

Whether the Court of Claims erred in holding that in computing a taxpayer's net income under Section 23 (n), Revenue Act of 1932, on the basis of which 15 percent is allowable for charitable deductions, a capital net loss should be disregarded.

STATUTE INVOLVED

The relevant portions of the Revenue Act of 1932 will be found in the Appendix, *infra*, pp. 26–30.

STATEMENT

This is a suit brought in the Court of Claims for the recovery of income tax paid for the year 1932 which the Court of Claims held the respondent was entitled to recover.

The special findings of fact of the Court of Claims may be summarized as follows:

Respondent duly filed his individual income tax return for the year 1932 on March 15, 1933, showing a total tax of $161.77, which was paid on the same date. On this return respondent reported a total income of $99,123.31, consisting of salaries, interest, and dividends, and total deductions of $5,235.15, consisting of taxes paid, losses by fire, storm, etc., and contributions to charitable organizations. He also reported a capital net loss of $157,642.62 (R. 12).

As a result of an audit of respondent's books and records the Commissioner of Internal Revenue determined that there was an additional tax due from the respondent in the amount of $908.92, and so notified respondent on April 13, 1934. The deficiency in tax of $908.92, together with interest of $60.87, aggregating $969.79, was thereafter assessed and, upon demand, the same was paid on May 12, 1934 (R. 12–13).

In arriving at the deficiency in tax the following adjustments were made: (1) Gross income was re-

duced to $96,702.67 from $99,123.31. (2) The total deductions claimed on the return were reduced to $1,739.15 from $5,235.15. This reduction was caused by the disallowance of the charitable deductions on the ground that since the ordinary net income reduced by the capital net loss resulted in a net loss for the year, there was no income against which to apply the 15% deduction for charitable contributions under Section 23 (n) of the Revenue Act of 1932. (3) Capital net loss was reduced to $154,921.98 from $157,642.62 (R. 13).

On May 19, 1934, respondent duly filed a claim for refund for $969.79 for 1932 upon the ground that the amount of $3,496 representing charitable contributions was less than 15 percent of his taxable net income and was a proper and legal deduction. The claim was rejected on January 17, 1935 (R. 13). This suit was filed in the Court of Claims March 6, 1936 (R. 1).

On April 4, 1938, the Court of Claims rendered an opinion in favor of respondent (R. 14–29), and entered judgment in the amount of $969.79, together with interest from May 12, 1934 (R. 29).

SPECIFICATION OF ERRORS TO BE URGED

The court below erred:

1. In holding that capital net losses are not deductible from gross income in arriving at the "net income" under Section 23 (n), Revenue Act of 1932.

2. In holding that the "net income" to be used as the base for the computation of the 15 percent de-

duction for charitable contributions is to be computed without taking into account a capital net loss sustained by the taxpayer, where the tax as computed under the provisions of Section 101, Revenue Act of 1932, is larger than the tax computed without regard to the provisions of that section.

3. In failing to hold that since the respondent's capital net loss exceeded his ordinary net income as computed without any adjustment for such capital net loss, there was no "net income" within the meaning of Section 23 (n), Revenue Act of 1932.

4. In failing to enter judgment for the United States and dismiss the petition.

SUMMARY OF ARGUMENT

I

Account must be taken of a capital net loss in computing the taxpayer's "net income" which forms the basis for the 15 per cent limitation on charitable deductions under Section 23 (n) of the Revenue Act of 1932. Net income is defined in the Act as gross income minus deductions allowed under Section 23. Gross income clearly includes capital gains, and the deductions allowed clearly include capital losses. The separate treatment of capital gains and losses in Section 101 does not affect the definition of "net income," but merely segregates ordinary net income from capital gains and capital losses for purposes of applying a different rate of tax.

The case is indistinguishable in principle from *Helvering* v. *Bliss*, 293 U. S. 144. In that case it

was held that a capital net gain must be taken into account in computing net income under Section 23 (n). Otherwise, it was pointed out, "ordinary net income" would be substituted for "net income." Four circuit courts of appeals and the Board of Tax Appeals have indicated that no distinction is to be drawn in the treatment of capital net gains and of capital net losses in this regard. The decision of the court below stands alone.

II

There are no considerations of policy which would justify a disregard of the terms of the Act. Although Congress has indicated a purpose to encourage charitable contributions, deductions therefor can be taken only where plainly permitted by the Act. Furthermore, there is a definite legislative policy to discourage the taking of capital losses for the purpose of offsetting ordinary net income. This purpose results in the requirement that a tax be paid even though the taxpayer has no actual income in the economic sense during the taxable year. This result, which is not questioned, constitutes a more fundamental hardship than any which may be pointed to in relation to the Commissioner's treatment of capital net losses for purposes of the limitation of charitable deductions.

III

The position of the Government is supported by administrative practice of long standing. The rule here contended for was announced in 1924 and has

been adhered to consistently thereafter, save for a period from 1932 to 1934 during which the problem was thrown into confusion by decisions of the Board of Tax Appeals. This confusion was resolved by the decision in the *Bliss* case, *supra*, and the Commissioner thereupon resumed the earlier consistent practice, to which the Government's position herein conforms.

ARGUMENT

I

IN COMPUTING NET INCOME ACCOUNT MUST BE TAKEN OF A CAPITAL NET LOSS, UNDER THE PLAIN TERMS OF THE ACT AND THE RATIONALE OF THE DECISION IN HELVERING V. BLISS, 293 U. S. 144

Respondent in 1932 made charitable contributions in the amount of $3,496. He had an "ordinary" net income, that is, gross income exclusive of capital gains minus allowable deductions exclusive of capital losses, in the amount of $94,963.52. He had capital losses in excess of capital gains—a capital net loss—in the amount of $154,921.98. Charitable contributions may be deducted from gross income under Section 23 (n) of the Revenue Act of 1932 only to the extent of 15 per cent of the taxpayer's "net income" computed without regard to charitable contributions. The case at bar turns on the meaning of the term "net income" as thus employed.

Respondent takes the position that his net income was $94,963.52 and that as his charitable contributions were less than 15 per cent of this amount, they

were deductible in full. The Commissioner's position is that that amount was "ordinary" net income as defined in Section 101 (c) (7) for purposes of computation of a tax at a separate rate; that in determining respondent's "net income" within Section 23 account must be taken of his capital net loss; that respondent had no net income; and that therefore no deduction for charitable contributions is permissible.

The Commissioner's position is that in determining "net income" as used in Section 23 (n), capital gains must be included in gross income and capital losses in deductions from gross income, and that this is true whether there is a capital net gain or a capital net loss. That this inclusion of capital gains and capital losses is the proper method in the case of a capital net gain is settled by *Helvering* v. *Bliss*, 293 U. S. 144. That decision held that the definition of net income in Section 21 is not affected by the fact that capital gains and capital losses are segregated by Section 101 for purposes of the application of a separate rate of tax to capital net gains. Respondent contends, however, that in the case of a capital net loss, where there is a similar segregation under Section 101 for purposes of a separate rate of deduction on capital net losses, capital gains and capital losses must be disregarded in computing "net income" under Section 21 and Section 23 (n).

In our view, the *Bliss* case does not permit of any distinction between the case of a capital net gain and the case of a capital net loss, with respect to the

meaning of "net income." Every court which has considered the question, except the court below, has shared our view. The question was squarely decided in *Avery* v. *Commissioner*, 84 F. (2d) 905 (C. C. A. 7th), certiorari denied, 299 U. S. 604, rehearing denied, 300 U. S. 686, and in *Lockhart* v. *Commissioner*, 89 F. (2d) 143 (C. C. A. 3rd), certiorari denied, 302 U. S. 711, and *Heinz* v. *Commissioner*, 94 F. (2d) 832 (C. C. A. 3rd). The Board of Tax Appeals has reached the same conclusion. *Nippert* v. *Commissioner*, 32 B. T. A. 892; *Hill* v. *Commissioner*, 33 B. T. A. 891, affirmed without consideration of the point, 88 F. (2d) 941 (C. C. A. 8th); *Zimmerman* v. *Commissioner*, 36 B. T. A. 618, pending in the Circuit Court of Appeals for the Third Circuit.[1] The same view has been expressed, though without specific decision of the point, in *Bliss* v. *Commissioner*, 68 F. (2d) 890, 892 (C. C. A. 2nd), affirmed 293 U. S. 144, *supra*, and *White* v. *Atkins*, 69 F. (2d) 960, 963 (C. C. A. 1st).

Before discussing the *Bliss* case, however, the provisions of the statute should be examined in greater detail. Section 23 (n) provides that the 15 per cent limitation on charitable deductions shall be measured by "net income." Net income is defined in section 21 to mean "gross income computed under Section 22, less the deductions allowed by section 23."

[1] To the same effect see *Lockhart* v. *Commissioner*, 32 B. T. A. 732, affirmed, 89 F. (2d) 143, *supra; Avery* v. *Commissioner*, 32 B. T. A. 948, affirmed, 84 F. (2d) 905, *supra; Heinz* v. *Commissioner*, 34 B. T. A. 885, affirmed, 94 F (2d) 832, *supra*.

Gross income computed under Section 22 clearly includes capital gains; it has been the scheme "of all the Revenue Acts since that of 1916 * * * to sweep all income of every sort, including capital gains, into what is denominated gross income * * *" (*Helvering* v. *Bliss*, 293 U. S. at 147). And the deductions allowed by Section 23 in the computation of net income clearly include capital losses, provided only that, as required by paragraph (e) of Section 23, they were incurred in trade or business or in transactions entered into for profit.[2] In the case at bar, therefore, in determining net income it is necessary to take into account the respondent's capital loss, which exceeded his gross income and so left no net income as a basis for deducting charitable contributions.

The result is not affected by the provisions of Section 101. That section provides for the segregation, in certain circumstances, of capital gains and capital losses from other income and the application of a separate rate to each of the two categories of income. Section 101 (a), the substance of which was contained in all the Revenue Acts from 1921 through

[2] If there were any doubt that Section 23 referred to capital losses, it would be removed by Section 101 (c) (4) of the Act, which provides that for the capital net loss determination the term "ordinary deductions" means "the deductions allowed by section 23 other than capital losses and capital deductions." There would be no necessity for the addition of the words "other than capital losses and capital deductions" if those items were not included in Section 23.

1932,[3] provides that where a taxpayer has a capital net gain, there shall, at his election, be levied, collected, and paid—

> * * * in lieu of all other taxes imposed by this title, a tax determined as follows: A partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total tax shall be this amount plus 12½ per centum of the capital net gain.

This was the provision under which the taxpayer in the *Bliss* case was taxed. The term "ordinary net income" as used in Section 101 is defined (101 (c) (7)) as "the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions." This Court held in the *Bliss* case that to disregard capital gains and capital losses in determining "net income" under Section 23 would be to substitute for net income the different concept "ordinary net income"; that the latter concept was introduced simply as part of a plan for segregating items of net income for purposes of applying separate rates; and that the definition of net income in Section 21 was in no wise affected by Section 101 (a).

Precisely the same analysis is applicable to Section 101 (b), the provision under which the respondent in the case at bar has been taxed. This subsection, the substance of which was contained in all the Revenue

[3] Act of 1921, Sec. 206; Acts of 1924 and 1926, Sec. 208; Act of 1928, Sec. 101.

Acts from 1924 through 1932,[4] provides that where a taxpayer sustains a capital net loss, there shall be levied, collected, and paid—

> * * * in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted, and the total tax shall be this amount minus 12½ per centum of the capital net loss; but in no case shall the tax of a taxpayer who has sustained a capital net loss be less than the tax computed without regard to the provisions of this section.

It will be observed that this subsection is mandatory where it will produce a greater tax,[5] while Section 101 (a) is permissive; but no distinction pertinent to the question here presented can turn on that difference. Section 101 (b), like 101 (a), provides for the segregation of ordinary net income on the one hand and capital gains and losses on the other, together with the application of a special rate, 12½ per cent, to the latter category. In the case of a taxpayer having a capital net gain (101 (a)), the

[4] Acts of 1924 and 1926, Sec. 208; Act of 1928, Sec. 101.

[5] Whether it will produce a greater tax depends, of course, on a comparison between the special rate and the normal and surtax rates applicable to the taxpayer's income. In Regulations 77, Article 503, an example is given of a case where the special rate would yield a smaller tax; the example is that of a taxpayer having an ordinary net income of $20,000 and a capital net loss of $13,000. See also Section 12 (c) of the 1932 Act, *infra*, p. 26.

special rate is applied to that gain and the product is added to the tax computed on ordinary net income. In the case of a taxpayer having a capital net loss (101 (b)), the special rate is applied to that loss and the product subtracted from the tax computed on ordinary net income. Thus in each case the item of capital gain and capital loss enters into the computation of the tax after being segregated from the other items of net income, which are denominated "ordinary net income." In neither case is there any basis for identifying "net income" with "ordinary net income." Yet the argument of respondent requires exactly such an identification.

The Court of Claims frankly and explicitly identified net income with ordinary net income, stating (R. 20):

> * * * in the case of a taxpayer having a capital net loss his *net income* as defined by section 23 (n) for the purpose of computing the allowable deduction for charitable contributions is "ordinary net income," which is the base for the calculation of the tax.

It was precisely this view that was rejected by this Court in the *Bliss* case, where it was said (293 U. S. at 146–147):

> For "net income," the base specified in § 23 (n) upon which the 15 per cent. deduction of charitable contributions is to be calculated, the petitioner would substitute "ordinary net income" as defined in § 101. So to read the Act would violate its plain terms and run counter to the history of the legislation.

Respondent argued in the court below that his definition of net income as excluding a capital net loss finds support in Section 21, which defines net income as gross income minus the deductions "allowed by section 23." Respondent contends that a capital net loss is not a deduction "allowed" by Section 23 where the tax is computed under Section 101 (b). This argument is untenable for a number of reasons. In the first place, what is allowed as a deduction by Section 23 is not in any event a capital net loss, but capital losses, just as capital gains are included in gross income under Section 22. If capital losses are not "allowed" under Section 23, it would necessarily follow that capital gains are not includible in Section 21; but no basis for such an exclusion has been, or could be, suggested, save the now exploded contention that net income means ordinary net income. In the second place, losses are "allowed" by Section 23 not for the purpose of computing the tax, but for the purpose of defining net income. The language of Section 23 itself is "In computing net income there shall be allowed as deductions:". The term "allowed" refers to the character of the losses and other items as permissible deductions in computing net income; for example, not every loss may be deducted or allowed, but only those incurred in trade or business or in transactions entered into for profit, and not compensated for by insurance or otherwise. In this sense the capital loss of respondent was unquestionably allowed by Section 23. Indeed, if respondent were correct in

insisting that his capital loss cannot be thus "allowed", the capital loss could not be utilized at all, for it can enter into the computation of a capital net loss only if it is a "deductible loss" (101 (c) (2)); and, similarly, capital deductions, which enter into the computation of a capital net loss in the same way as do capital losses, are specifically limited to "such deductions as are allowed by section 23 for the purpose of computing net income" (101 (c) (3)). It is thus plain that capital losses and capital deductions are "allowed" by section 23 where, as here, they enter into the computation of a tax at the special rates provided under Section 101 (b), no less than where the tax is computed without regard to Section 101 (b). In short, the allowance of a capital loss as a deduction under Section 23, so far from being inconsistent with the special treatment of a capital net loss under Section 101 (b), is in fact a necessary condition of such special treatment. In the third place, even if the deductions "allowed" by Section 23 were synonymous with deductions entering into the computation of the tax, the capital loss involved was allowed in that sense also. The effect of the segregation required by Section 101 (b) is simply to tax capital gains at a special rate and deduct capital losses therefrom at the same rate, and to deduct the remainder from ordinary net income taxed at the ordinary rates. The capital loss, or capital net loss, is deducted from gross income in computing the tax, though a rate has been applied

to it different from the rate applied to ordinary deductions.[6] In explaining the provision originally introduced in the 1924 Act which corresponds to Section 101 (b), the Chairman of the Ways and Means Committee of the House made it clear that capital losses were to be allowed as deductions, only the rate being modified; the effect of the provision, he explained, was (65 Cong. Rec., p. 2428)—

> that capital gains and capital losses shall both be placed on the same basis; that capital gains shall be taxed at 12½ per cent, at the election of the taxpayer, and that *capital losses shall*

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[6] A simple formula will demonstrate the point. Let R=rate of tax; o=ordinary income (i. e., gross income exclusive of capital gains); c=capital gains; o^1=ordinary deductions; c^1=capital losses and capital deductions. Then the tax computed without regard to section 101 is $R(o+c-[o^1+c^1])$, or $Ro+Rc-Ro^1-Rc^1$, or $R(o-o^1)+R(c-c^1)$. Section 101 merely substitutes for R a different rate to be applied to c and c^1. This rate may be designated r. Then the tax computed under section 101 is $R(o-o^1)+r(c-c^1)$, or $Ro+rc-Ro^1-rc^1$. It is evident that in the computation of the tax capital gains are included and capital losses deducted, whether or not the tax is computed under section 101, and that the only difference arising from the application of section 101 is in the rate applied to the capital items.

only receive an allowance for deduction at the rate of 12½ per cent.[7] [Italics supplied.]

Respondent contends also, in seeking statutory support for his position, that net income means taxable net income, that respondent's taxable income is his ordinary net income, and that, therefore, his net income is the same as his ordinary net income. Each of the premises of this syllogism is faulty. In the first place, the statute does not use the term "taxable net income." If it did, it would have been necessary to define the term.[8] Instead, the statute

[7] *Piper* v. *Willcuts*, 64 F. (2d) 813 (C. C. A. 8th), and *Hoffman* v. *Commissioner*, 71 F. (2d) 929 (C. C. A. 2d), cited in respondent's brief in response to the petition for certiorari (p. 1), do not advance respondent's argument, nor do they support the proposition for which they were cited, that a capital net loss "is not a permissible deduction from gross income in computing * * * taxable net income." Those cases hold simply that where there is a capital loss and no capital gain, there is a capital net loss, and accordingly the capital loss is subject to the limitation on rate of deduction in Section 101 (b).

[8] It is true that the Act of October 3, 1917, did use the term "taxable net income" as the base for measuring the maximum deduction for charitable contributions (see R. 21–22). At that time capital gains and losses were not treated separately, and hence there was probably neither significance nor confusion in the use of the term. But beginning with the 1918 Act, and continuously thereafter through the 1932 Act, the term employed has been "net income", appropriately defined. No explanation for the change made in the 1918 Act appears to have been given; the term "taxable" may have been regarded as surplusage at that time, or it may have been thought productive of confusion, as it would have been after the Acts of 1921 and 1924, which began the separate treatment of capital gains and losses.

employs, with explicit definition, the term "net income," which we have already analyzed. In the second place, if the concept of taxable net income is to be imported, it cannot be given the meaning of ordinary net income. To give it that meaning would ignore the fact that, as has been explained, not only ordinary net income but capital gains and losses as well enter into the computation of the tax where there is a capital net gain or a capital net loss. Respondent's argument that his taxable income and his ordinary net income are the same is apparently based on the notion that his ordinary net income is taxed at the rates prescribed in Sections 11 and 12, and the rates in those sections are stated to be applicable to net income. The fallacy in this argument is the assumption that respondent is taxed at all under Sections 11 and 12. In fact, respondent is taxed under Section 101 (b), which levies a tax "in lieu of all other taxes imposed by this title." Section 12 (c) itself recognizes that Section 101, where applicable, imposes a tax "in lieu of normal and surtax." Section 101 (b) occupies the same position in the structure of the Act as Sections 11 and 12, being entitled "Rates of Tax," and where applicable it wholly supersedes the earlier sections. Section 101 (b) simply applies to ordinary net income the rates prescribed in Sections 11 and 12 for net income. It incorporates those rates, as it were, by reference. But only the rates are the same; the subject of the

tax at those rates is net income under Sections 11 and 12 and ordinary net income (prior to the deduction of a capital net loss) under Section 101 (b). There is no more basis for confusing the two here than there was in the *Bliss* case.

What has been said, it is submitted, indicates that under the terms of the Act ordinary net income is not to be confused with net income, that hence a capital net loss must be taken into account in determining net income under Section 23 (n), and that in principle the *Bliss* case, which involved a capital net gain, is indistinguishable from the case at bar. The pertinence of the *Bliss* case to the question of a capital net loss does not rest, however, merely on implication from the decision. The opinion in that case appears to recognize its relevance to the present question. The Circuit Court of Appeals in the *Bliss* case had expressly adverted to this question and had declared that since a capital net loss would be taken into account equally with a capital net gain any advantage to the taxpayer in the situation then before the court would be counterbalanced by the advantage to the Government in the situation which is now presented. The Court of Appeals said (68 F. (2d) at 892):

> It is to be noted that the phrase "ordinary net income" occurs in both paragraph (a), which deals with the case of capital net gain, and paragraph (b), which deals with the case of capital net loss. It must have the same meaning in each. A construction favorable to the taxpayer in the former will operate to

> his detriment in the latter, and vice versa. Hence the canon of strict construction invoked by the commissioner on the theory that the taxpayer is claiming the benefit of an exemption seems inapplicable. We can hardly say that there is any plain advantage to be gained by taxpayers from one construction rather than the other; it depends on whether in the long run cases of capital net gain involve larger sums than cases of capital net loss.

In affirming the decision this Court did not take issue with the reasoning of the Court of Appeals. On the contrary, the opinion of this Court likewise treated the two situations as correlative. The opinion (293 U. S. at 146, note) cited the decision of the Board of Tax Appeals in *Straus* v. *Commissioner*, 27 B. T. A. 1116, in accord with the *Bliss* decision, as a reversal not only of the Board's earlier decisions with respect to capital net gains, but also of the Board's earlier decisions holding that capital net losses are not to be taken into account in computing net income. (*Elkins* v. *Commissioner*, 24 B. T. A. 572; *Livingood* v. *Commissioner*, 25 B. T. A. 585). Furthermore the opinion of this Court refers to the consistent administrative practice from 1923 to 1932 in harmony with the conclusion reached in the *Bliss* case, citing, *inter alia*, I. T. 2104, III-2 Cum. Bull., p. 152. This ruling, announced in 1924, dealt with capital losses, without differentiation between a capital net loss and a capital net gain.

As has been pointed out above (p. 8), four Circuit Courts of Appeals and the Board of Tax Appeals are of opinion that the treatment of capital net gains in accord with the decision in the *Bliss* case requires a treatment of capital net losses in accord with the practice followed by the Commissioner in the present case.

II

THERE ARE NO CONSIDERATIONS OF POLICY WHICH WOULD JUSTIFY A DISREGARD OF THE TERMS OF THE ACT

Respondent contends that the Commissioner has failed to give effect to the Congressional policy of encouraging charitable contributions. It must be remembered, however, that charitable deductions are a matter of grace and can only be allowed where the terms of the Act are plainly met. Even under the estate tax, where, unlike the income tax, charitable contributions are deductible in full, the deduction may be taken only if plainly permitted by the statute. *Taft* v. *Commissioner*, 304 U. S. 351; cf. *Crooks* v. *Harrelson*, 282 U. S. 55, 60; *Helvering* v. *Inter-Mountain Ins. Co.*, 294 U. S. 686, 689-690.

Furthermore, the position of the Commissioner does not ignore the legislative policy of encouraging charitable contributions. As has been observed, although the Commissioner's position is relatively unfavorable to the taxpayer in the present situation, it is the logical corollary of the decision in the *Bliss* case, where the result was to the advantage of

the taxpayer. It may also be pointed out that the Commissioner's treatment of a capital net loss is favorable to the taxpayer under Section 120, which provides that where charitable contributions exceed 90 per cent of net income and have done so for the preceding 10 years, the entire amount of the contributions in the taxable year may be deducted. Since net income is diminished by taking account of a capital net loss, it becomes easier for a taxpayer to take advantage of Section 120 by showing that his charitable contributions have exceeded 90 per cent of his net income.

Finally, the policy of encouraging charitable contributions cannot be viewed in isolation. Another definite and countervailing policy of Congress must be considered: the discouragement of the taking of capital losses to offset ordinary net income. The opportunity to minimize taxes by such a practice constituted a particularly serious problem after the Act of 1921, which reduced the rate of tax on capital net gains. The 1924 Act subjected capital net losses to a correspondingly limited rate in order to protect the revenues. See *Piper* v. *Willcuts*, 64 F. (2d) 813, 815–816 (C. C. A. 8th); 65 Cong. Rec. 2428; H. Rep. 179, 68th Cong., 1st sess., p. 20. The result is that although a taxpayer, like respondent, has no actual income in the economic sense, he nevertheless must pay a tax. This result has been characterized as a "glaring inconsistency" that must nonetheless be given effect (Mr. Justice Roberts, dissenting, in

Helvering v. *New York Trust Co.*, 292 U. S. 455, 472).[9] In comparison with this basic result of the capital net loss provisions, any hardship or apparent incongruity flowing from the denial of a deduction for charitable contributions is relatively insignificant.

In the face of the quite drastic policy regarding capital net losses the courts cannot be asked, it is submitted, to depart from the text of the Act and give controlling force to a policy of encouraging charitable contributions. The problem of harmonizing these policies was one peculiarly for Congress. As will be shown, Congress took no steps to change the administrative practice, which from 1924 to the present time, save for a period of approximately two years, has been consistently in accord with the result for which we here contend.

III

ADMINISTRATIVE PRACTICE OF LONG STANDING SUPPORTS THE POSITION OF THE GOVERNMENT

Shortly after the 1924 Act went into effect, the Commissioner ruled, as we are here maintaining, that capital losses must be taken into account in determining net income for the purpose of measuring the limitation on charitable deductions. I. T. 2104, III-2 Cum. Bull. 152. This ruling has governed the administrative practice under the Acts of 1924, 1926, 1928, and 1932 to the present time, save for a period

[9] While the characterization was made in a dissenting opinion, it was illustrative only and was not the subject of any difference of opinion.

from 1932 to 1934, when the question was thrown into confusion b̦ decisions of the Board of Tax Appeals and was finally resolved by this Court in the *Bliss* case in favor of the earlier consistent practice. The circumstances of this short-lived departure from I. T. 2104 merit explanation.

In November 1931, the Board of Tax Appeals decided, in the *Elkins* and *Livingood* cases, 24 B. T. A. 572, 25 *id.* 585, that I. T. 2104 was erroneous with respect to the 1924 Act, and that capital net losses should not be taken into account in determining net income—exactly the position of respondent in the case at bar. In January 1932, the Bureau announced that the *Elkins* decision would be appealed and that I. T. 2104 would not be revoked or modified, but that until the question should finally be settled it would be necessary to protect the revenues by tentatively adopting a rule in relation to capital net gains comparable to the rule of the *Elkins* case in relation to capital net losses. The Commissioner stated (Mim. 3931, XI-1 Cum. Bull. 33)—

> The Board's decision is contrary to the position which the Bureau has consistently followed as announced in I. T. 2104 (C. B. III-2, 152). The decision will be appealed, and in the audit of returns involving capital net losses, the Bureau will continue to follow I. T. 2104.
>
> In view, however, of the decision of the Board in the *Elkins* case, and pending the final decision of the courts on the question, it will also be necessary, in order to protect

fully the interests of the Government, in cases where a taxpayer has a "capital net gain," to compute the 15 per cent limitation on the deduction for contributions upon the basis of the net income excluding the "capital net gain."

A few months later, in August 1932, the Board of Tax Appeals decided *Harbison* v. *Commissioner*, 26 B. T. A. 896, involving a capital net gain, and applied the rule of the *Elkins* case to that situation, producing a result favorable to the Government. It was then that the bureau decided to accept the decisions of the Board in both classes of cases. The non-acquiescences in the *Elkins* and *Livingood* cases were revoked, and acquiescenses were announced. XI-2 Cum. Bull. 3, 6; Mim. 3986, XI-2 Cum. Bull. 29. I. T. 2104 was modified accordingly to make it inapplicable to the 1924 Act. See I. T. 2668, XI-2 Cum. Bull. 268. Following this change of position by the Bureau, the Board of Tax Appeals overruled its decisions dealing with capital net gains (*Straus* v. *Commissioner*, 27 B. T. A. 1116), leaving unsettled the question whether the rulings with respect to capital net losses were also overruled.

It was while the problem was in this state of extreme confusion that the Government sought to sustain the Board's overruled decision in the *Harbison* case, which corresponded to the ruling in the *Elkins* case and which involved a departure from I. T. 2104 and the practice from 1924 to 1932. The departure from I. T. 2104 lasted only until the deci-

sion of this Court in *Helvering* v. *Bliss* (together with *Helvering* v. *Harbison*), 293 U. S. 144.

After that decision the Bureau returned to its former settled practice with respect to both capital net gains and capital net losses, reinstating I. T. 2104. See G. C. M. 14030, XIII-2 Cum. Bull. 135; *id.*, 25, 29. In the case at bar the Government seeks to apply I. T. 2104, which was cited in the *Bliss* case, 293 U. S. at 151, as reflecting the correct administrative practice, approved by several reenactments of the statutory provisions in question.

Respondent seeks to have the Commissioner return full circle to the rule of the Board in the *Elkins* case, which gave rise to the period of confusion and which, we submit, was finally disapproved by this Court in the *Bliss* case.

CONCLUSION

For the reasons stated the decision of the court below is erroneous and should be reversed.

Respectfully submitted.

ROBERT H. JACKSON,
Solicitor General.

JAMES W. MORRIS,
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OCTOBER 1938.

APPENDIX

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 11. NORMAL TAX ON INDIVIDUALS.

There shall be levied, collected, and paid for each taxable year upon the net income of every individual a normal tax equal to the sum of the following: * * *.

SEC. 12. SURTAX ON INDIVIDUALS.

(a) RATES OF SURTAX.—There shall be levied, collected, and paid for each taxable year upon the net income of every individual a surtax as follows: * * *.

* * * * *

(c) CAPITAL NET GAINS AND LOSSES.—For rate and computation of tax in lieu of normal and surtax in case of net incomes of not less than $16,000, approximately, or in case of net incomes, excluding items of capital gain, capital loss, and capital deductions, of not less than $16,000, approximately, see section 101.

SEC. 21. NET INCOME.

"Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

SEC. 22. GROSS INCOME.

(a) GENERAL DEFINITION.—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

SEC. 23. DEDUCTIONS FROM GROSS INCOME. In computing net income there shall be allowed as deductions:

*   *   *   *   *

(e) LOSSES BY INDIVIDUALS.—Subject to the limitations provided in subsection (r) of this section, in the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or

(3) of property not connected with the trade or business, if the loss arises from fires, storms, shipwreck, or other casualty, or from theft. No loss shall be allowed as a deduction under this paragraph if at the time of the filing of the return such loss has been claimed as a deduction for estate tax purposes in the estate tax return.

*   *   *   *   *

(n) CHARITABLE AND OTHER CONTRIBUTIONS.—In the case of an individual, contributions or gifts made within the taxable year to or for the use of: * * * to an amount which in all the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this subsection. Such contributions or gifts shall be allowable as deductions only if verified under rules and regulations prescribed by the Commissioner, with the approval of the Secretary.

*   *   *   *   *

(r) LIMITATION ON STOCK LOSSES.—(1) Losses from sales or exchanges of stocks and bonds (as defined in subsection (t) of this section) which are not capital assets (as defined

in section 101) shall be allowed only to the extent of the gains from such sales or exchanges (including gains which may be derived by a taxpayer from the retirement of his own obligations).

* * * * *

SEC. 101. CAPITAL NET GAINS AND LOSSES.

(a) TAX IN CASE OF CAPITAL NET GAIN.—In the case of any taxpayer, other than a corporation, who for any taxable year derives a capital net gain (as hereinafter defined in this section), there shall, at the election of the taxpayer, be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: A partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total tax shall be this amount plus 12½ per centum of the capital net gain.

(b) TAX IN CASE OF CAPITAL NET LOSS.—In the case of any taxpayer, other than a corporation, who for any taxable year sustains a capital net loss (as hereinafter defined in this section), there shall be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted, and the total tax shall be this amount minus 12½ per centum of the capital net loss; but in no case shall the tax of a taxpayer who has sustained a capital net loss be less than the tax computed without regard to the provisions of this section.

(c) DEFINITIONS.—For the purposes of this title—

(1) "Capital gain" means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.

(2) "Capital loss" means deductible loss resulting from the sale or exchange of capital assets.

(3) "Capital deductions" means such deductions as are allowed by section 23 for the purpose of computing net income, and are properly allocable to or chargeable against capital assets sold or exchanged during the taxable year.

(4) "Ordinary deductions" means the deductions allowed by section 23 other than capital losses and capital deductions.

(5) "Capital net gain" means the excess of the total amount of capital gain over the sum of (A) the capital deductions and capital losses, plus (B) the amount, if any, by which the ordinary deductions exceed the gross income computed without including capital gains.

(6) "Capital net loss" means the excess of the sum of the capital losses plus the capital deductions over the total amount of capital gain.

(7) "Ordinary net income" means the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions.

(8) "Capital assets" means property held by the taxpayer for more than two years (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business. * * *

SEC. 120. UNLIMITED DEDUCTION FOR CHARITABLE AND OTHER CONTRIBUTIONS.

In the case of an individual if in the taxable year and in each of the ten preceding taxable

years the amount of the contributions or gifts described in section 23 (n) plus the amount of income, war profits, or excess-profits taxes paid during such year in respect of preceding taxable years, exceeds 90 per centum of the taxpayer's net income for each such year, as computed without the benefit of section 23 (n), then the 15 per centum limit imposed by such section shall not be applicable.

U. S. GOVERNMENT PRINTING OFFICE: 1939

FILE COPY

No. 169

IN THE

Supreme Court of the United States

October Term, 1938

THE UNITED STATES,
Petitioner

v.

FREDERICK PLEASANTS

RESPONDENT'S BRIEF

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IN THE

Supreme Court of the United States

October Term, 1938

No. 169

THE UNITED STATES,
Petitioner

v.

FREDERICK PLEASANTS

RESPONDENT'S BRIEF

While we earnestly urge that the decision of the Court of Claims in this case, holding:

(1) that the base specified in Section 23 (n) of the Revenue Act of 1932 for the calculation of the 15% limitation on the amount deductible for charitable contributions is the taxpayer's taxable net income, as computed without the benefit of the deduction;

(2) that a "capital net loss," as defined by Section 101 (c) (6) of the Revenue Act of 1932 is not a permissible deduction from gross income in computing such taxable net income (*Piper* v. *Willcuts*, (CCA 8), 64 F. (2d) 813 affirming 55 F. (2d) 397; *Hoffman* v. *Commissioner*, (CCA 2), 71 F. (2d) 929; and

(3) that the base specified in Section 23 (n) for the allowance of contributions is not to be re-

duced or extinguished, by an unauthorized deduction,

is a correct interpretation of the statute, and effectuates the evident intent of Congress to encourage contributions to charitable institutions, we respectfully submit that it is entirely proper for the Court to grant certiorari, because of the alleged conflict between the decision below, and the result reached by the Seventh Circuit in *Avery* v. *Commission*, 84 F. (2d) 905, and the Third Circuit in *Lockhart* v. *Commissioner*, 89 F. (2d) 143 and *Heinz* v. *Commissioner*, 94 F. (2d) 832. There is no conflict between the decision below and *Helvering* v. *Bliss*, 293 U. S. 144.

The question at issue is presently pending before the Third Circuit in *Zimmerman* v. *Commissioner*, 36 B.T.A. 618, on appeal from the Board's decision, and *Heinz* v. *Commissioner*, supra, on petition for rehearing, and before the Eighth Circuit in *Watkins* v. *Commissioner*, *Moulton* v. *Commissioner* and *Johnson* v. *Commissioner*, on appeal from a memorandum decision of the Board.

Respectfully submitted,

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July, 1938.

IN THE

Supreme Court of the United States

October Term, 1938

No. 169

THE UNITED STATES,
Petitioner

v.

FREDERICK PLEASANTS

ON A WRIT OF CERTIORARI TO THE COURT OF CLAIMS

BRIEF FOR RESPONDENT

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INDEX

CITATIONS

CASES:

MISCELLANEOUS

IN THE

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FREDERICK PLEASANTS

ON A WRIT OF CERTIORARI TO THE COURT OF CLAIMS

BRIEF FOR RESPONDENT

OPINION BELOW

The findings of fact and opinion of the Court of Claims of the United States (R. 11-29) are reported in 22 F. Supp. 964.

JURISDICTION

The judgment of the Court of Claims was entered on April 4, 1938. (R. 29.) The Government filed a petition for a writ of certiorari on July 1, 1938, and the same was granted on October 10, 1938. The jur-

isdiction of this Court is conferred by Section 3 (b) of the Act of February 13, 1925.

STATEMENT OF THE CASE

The sole controversy presented by this case is whether the respondent taxpayer is entitled to a deduction for income tax purposes for the contributions which he made to charitable institutions in the calendar year 1932.

During the year 1932, the respondent made charitable contributions of a character deductible under Section 23 (n) of the Revenue Act of 1932 in the amount of $3,496.00, and claimed a deduction for the same in his individual income tax return for that year. (R. 5; Fdg. 2, R. 12.)

The Commissioner of Internal Revenue in auditing the respondent's return for the year 1932 disallowed in its entirety the claimed deduction for contributions. The Commissioner determined the respondent's "net income," i. e., gross income less permissible deductions, to be $94,963.52, as computed without the benefit of any deduction for contributions. (Fdgs. 3 and 4, R. 12-13.) The respondent in the year 1932 sustained a "capital net loss" of $154,921.98, which was not a permissible deduction in the computation of the aforesaid net income of $94,963.52. (R. 5, 7; Fdgs. 3 and 4, R. 12-13.)

In the calculation of taxes, the Commissioner of Internal Revenue treated the said sum of $94,963.52 as the "net income," to be taxed under Sections 11 and 12, which prescribe the normal and surtax rates on net income, and against the taxes thus determined, he allowed, pursuant to Section 101 (b), a credit of 12½ per cent of the aforesaid capital net loss, the difference representing the tax due. The Commissioner determined the total tax assessable against the re-

spondent on his "net income" to be $1,070.69. (R. 5, 7-8; Fdgs. 3 and 4, R. 12-13.)

While the Commissioner employed the said sum of $94,963.52 as the "net income," taxable under Sections 11 and 12, he held that the respondent had no "net income," for the purpose of allowing a deduction for contributions. (R. 7-10; Fdgs. 3 and 4, R. 12-13.) Section 23 (n) limits the deduction for contributions to 15 per cent of the "net income," as computed without the benefit of the deduction.

In the Commissioner's view of the statute, the term "net income," as used in Section 23 (n), as applied to the facts of this case, means the "net income," subject to tax under Sections 11 and 12, *less* the nondeductible capital net loss. When the capital net loss of $154,921.98 is subtracted from the taxable net income of $94,963.52, a net loss of more than $59,000.00 is produced, (R. 12); and the base for measuring the 15 per cent limitation prescribed by Section 23 (n) is thereby wholly destroyed. The Commissioner held that although the respondent had a "net income," for the imposition of taxes, he had no "net income," within the purview of that term as used in Section 23 (n), and that therefore he was not entitled to any deduction for contributions.

In our view of the statute, the respondent's "net income," $94,963.52, which was subjected to tax under Sections 11 and 12, is the base for the calculation of the 15 per cent limitation under Section 23 (n), because it represents the respondent's net income as computed without the benefit of the deduction for contributions, and since the respondent's contributions of $3,496.00 are well within the prescribed limitation, they are deductible in full.

We cannot subscribe to the Commissioner's view that the respondent here has a "net income" subject

to tax under Sections 11 and 12 for the year 1932, and at the same time has a "net loss," for the year 1932 for the purpose of Section 23 (n).

THE QUESTION AT ISSUE

The question at issue is simply this: Is the respondent under the facts of his case entitled to a deduction for income tax purposes for the contributions in the sum of $3,496.00 which he made to charitable institutions in the calendar year 1932?

The base for measuring the 15 per cent limitation on the amount allowable as a deduction for contributions under Section 23 (n) is "net income," as computed without the benefit of the deduction. Did the respondent have a "net income," within the purview and contemplation of that term as used in Section 23 (n), and other parts of the Act? Did Congress by the use of the term "net income," appearing in Section 21 intend to provide a base for the calculation of the taxes? Does the respondent have a "net income," of $94,963.52 subject to the normal and surtaxes prescribed by Sections 11 and 12, and at the same time have a "net loss," of more than $59,000.00 for the purpose of Section 23 (n) Why the discrimination? Did Congress intend to attach conflicting meanings to the term "net income," in the case of a taxpayer who sustained a "capital net loss," which is excluded in the computation of taxable net income? Congress, commencing with the Revenue Act of 1924, legislated against the deduction of a "capital net loss," in computing net income subject to tax. Does the Commissioner of Internal Revenue have the right to deduct a nondeductible "capital net loss," and thereby impair or destroy the base specified in Section 23 (n) for measuring the 15 per cent limitation on the amount deductible for contributions? Did Congress

intend to deny to a taxpayer a deduction for a "capital net loss," and at the same time grant to the Commissioner the right to deduct it for the purpose of reducing or denying altogether a deduction for contributions? Is there any language in the Act which supports such an anomalous process?

THE FACTS

The findings of fact of the Court of Claims may be summarized as follows:

The respondent filed his individual income tax return for 1932 on March 15, 1933, showing a total tax of $161.77, which was paid on the same date. In that return he reported in line 12 a total income of $99,123.31 consisting of salaries, interest, and dividends, and on line 19 of the return he reported total deductions of $5,235.15 consisting of taxes paid, losses by fire, storm, etc., and under item 17, contributions. The respondent also reported in line 32 of the return under the heading "Computation of Tax" a capital net loss of $157,642.62. The respondent in his return for 1932 reported his income, deductions, losses, and tax as follows:

INCOME

Item and Instruction No.			
1.	Salaries, Wages, Commissions, Fees, etc.		
	Nat. Bellas Hess Co., New York		$ 900.00
	" " " " " " rector's fees		120.00
3.	Interest on Bank Deposits, Notes, Corporation Bonds, etc. (except interest on tax-free covenant bonds)		10,988.62
9.	Taxable Interest on Liberty Bonds, etc. (from Schedule E)		922.25
10.	Dividends on: (a) Stock of Domestic Corporations subject to taxation under Title I of 1932 Act		85,761.94
	(c) Stock of Foreign Corporations and bonds		430.50
12.	Total Income in Items 1 to 11		$99,123.31

DEDUCTIONS

14.	Taxes Paid. (Explain in Schedule F)		$ 1,639.15
15.	Losses by Fire, Storm, etc. (Explain in Table at foot of page 2)		100.00
17.	Contributions (Explain in Schedule F)		3,496.00
19.	Total Deductions in Items 13 to 18		$ 5,235.15
20.	Net Income (Item 12 minus Item 19)		$93,888.16

COMPUTATION OF TAX (See Instruction 23)

23.	Net Income Subject to Tax		$93,888.16
24.	Less: Interest on Liberty Bonds, etc. (Item 9)	$ 922.25	
25.	Dividends (Item 10(a))	85,761.94	
26.	Personal Exemption	2,500.00	
28.	Total of Items 24 to 27	$89,184.19	89,184.19
29.	Balance subject to Normal Tax (Item 23 minus 28)		$ 4,703.97
30.	Amount taxable at 4% (not over $4,000)		4,000.00
31.	Amount taxable at 8% (Item 29 minus 30)		703.97
32.	Amount of Capital Net Gain or Loss (from Schedule D)	(loss)	$157,642.62
33.	Normal Tax (4% of Item 30)		$ 160.00
34.	Normal Tax (8% of Item 31)		56.31
35.	Surtax on Item 22 (See Instruction 23)		19,650.79
36.	Tax on net income (total of Items 33 to 35)		19,867.10
37.	Adjustment for Capital Gain or Loss (12½% of Item 32)		19,705.33
38.	Total Tax (total of or difference between Items 36 and 37)		$ 161.77

(R. 5; Fdg. 1, R. 12.)

In arriving at the total deduction of $5,235.15 shown on line 19 of this return, the respondent included therein as a deduction the amount of $3,496.00, representing contributions or gifts made by him within the taxable year 1932 to the St. James' Church, Community Chest, Red Cross, Salvation Army, Y. M. C. A., and other charitable institutions, within the purview of Section 23 (n) of the Revenue Act of 1932. (Fdg. 2, R. 12.)

The Commissioner of Internal Revenue caused an investigation and audit to be made of respondent's books and records, and his return for 1932, and, on January 20, 1934, pursuant to the instructions of the Commissioner, the Internal Revenue Agent in Charge at Newark, New Jersey, made such investigation and audit and on February 20, 1934, prepared and submitted a report to the Commissioner, showing the following:

Schedule No. 1

BLOCK ADJUSTMENTS

		Return	Additions to income	Deductions from income	Corrected
1	Salaries	1,020.00			1,020.00
2					
3	Interest	10,988.62			10,988.62
4					
5					
6					
7					
8	Profit on mortgages			(a) (2,420.64)	(2,420.64)
8a					
9	Liberty bond interest	922.25			922.25
10	Dividends	85,761.94			85,761.94
	(c) Bonds	430.50			430.50
12		99,123.31			96,702.67
13					
14	Taxes	1,639.15			1,639.15
15	Losses	100.00			100.00
16					
17	Contributions	3,496.00	(b) 3,496.00		
18					
		5,235.15			1,739.15
	Total income	93,888.16	3,496.00	(2,420.64)	94,963.52

		Year Period ended 1932
Schedule No. 2		

COMPUTATION OF TAX

Net income (from Schedule 1)		$94,963.52
Less: Net loss (section 117 of 1928 or 1932 Act)		
Capital net gain		
Income subject to surtax		$94,963.52
Less: Dividends	$85,761.94	
Interest on Liberty Bonds, etc.	922.25	
Personal exemption and credit for dependents	2,500.00	89,184.19
Balance subject to normal tax		$ 5,779.33
Normal tax at 4% on $ 4,000.00	$ 160.00	
Normal tax at 8% on $ 1,779.33	142.35	
Surtax on $94,963.52	20,133.58	
Tax at 12½% on capital net loss of $154,921.98	(19,365.24)	$ 1,076.69
Total tax		$ 1,070.69
Total tax assessable		$ 1,070.69
Tax previously assessed		161.77
Additional tax to be assessed		$ 908.92

The Internal Revenue Agent in Charge determined the respondent's gross income to be $96,702.67 instead of $99,123.31, as reported by the respondent on line 12 of his return, and the total deductions to be $1,739.15 instead of $5,235.15, as reported by the respondent on line 19 of his return. In so reducing the total deductions from $5,235.15, as reported by plaintiff, to $1,739.15, the Internal Revenue Agent in Charge disallowed as a deduction the charitable contributions in the amount of $3,496.00, as set forth in finding 2 of the Court below, on the ground that the capital net loss was a proper deduction in determining the "net income" for the purpose of the deduction for charitable contributions under Section 23 (n), and since the ordinary net income reduced by the capital net loss resulted in a net loss for the year there was no income against which to apply the deduction for charitable contributions. The Internal Revenue Agent in Charge also determined plaintiff's capital net loss to be $154,921.98 instead of $157,642.62, as reported on line 32 of the return. The total tax assessable against the respondent as shown in the audit by the Internal Revenue Agent in Charge as set forth in his report hereinbefore mentioned was $1,070,69, or $908.92 in excess of $161.77, which amount the respondent had reported and paid as set forth in finding 1 of the Court below. This additional tax resulted entirely from the disallowance of the deduction for charitable contributions in determining net income subject to tax. (R. 7-9; Fdg. 3, R. 12-13.)

The Commissioner upon examination and audit of respondent's return in connection with the report of the Internal Revenue Agent in Charge, approved the findings, audit, and computation of the tax recommended by the Revenue Agent in Charge and so notified the respondent on April 13, 1934. The respon-

dent's taxable net income for 1932 was $94,963.52 before any deduction for charitable contributions. The deficiency in tax of $908.92, together with interest thereon of $60.87, aggregating $969.79, was thereafter assessed and upon demand the same was paid May 12, 1934. (R. 9-10; Fdg. 4, R. 13.)

Thereafter, May 19, 1934, the respondent duly filed a timely claim for refund for $969.79 for 1932 on the ground that the amount of $3,496.00 representing contributions to charity, being less than 15 per cent of his taxable net income, was a proper and legal deduction under Section 23 (n) of the Revenue Act of 1932 in computing his net income subject to tax. The Commissioner rejected this claim in its entirety on January 17, 1935, giving as his reasons therefor the following:

> "In this connection you are advised that in the cases of Susan Dwight Bliss v. Commissioner and William Albert Harbison v. Commissioner, decided November 5, 1934, the Supreme Court of the United States decided that the base for computing the 15 per cent limitation on contributions is the gross income less all permissible deductions save contributions, regardless of whether the tax is computed under the capital net gain or net loss provisions of the Revenue Acts prior to the Revenue Act of 1934.
>
> "In accordance with the above decision the ordinary net income must be reduced by the amount of the capital net loss in order to arrive at the base on which to compute the 15 per cent limitation for contributions. Since the capital loss of $154,921.98 is in excess of adjusted ordinary net income of $94,963.52 (without contributions) there is no net income against which to make a deduction for contributions. Contributions claimed in the amount of $3,496.00 cannot therefore be allowed."

(R. 10; Fdg. 5, R. 13-14.)

THE STATUTE

The pertinent parts of the Revenue Act of 1932 are as follows:

SUBTITLE B—GENERAL PROVISIONS

Part I—Rates of Tax

SEC. 11. NORMAL TAX ON INDIVIDUALS.

There shall be levied, collected, and paid for each taxable year upon the net income of every individual a normal tax equal to the sum of the following:

(a) 4 per centum of the first $4,000 of the amount of the net income in excess of the credits against net income provided in section 25; and

(b) 8 per centum of the remainder of such excess amount.

SEC. 12. SURTAX ON INDIVIDUALS.

(a) Rates of Surtax.—There shall be levied, collected, and paid for each taxable year upon the net income of every individual a surtax as follows:

Upon a net income of $6,000 there shall be no surtax; upon net incomes in excess of $6,000 and not in excess of $10,000, 1 per centum of such excess.

$40 upon net incomes of $10,000 and upon net incomes in excess of $10,000 and not in excess of $12,000, 2 per centum in addition to such excess. * * *

$491,460 upon net incomes of $1,000,000; and upon net incomes in excess of $1,000,000, 55 per centum in addition of such excess.

Part II—Computation of Net Income

SEC. 21. NET INCOME.

"Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

SEC. 22. GROSS INCOME.

(a)* General Definition.—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) Expenses * * *; (b) Interest * * *; (c) Taxes Generally * * *; (d) Taxes of Shareholder Paid by Corporation * * *;

(e) Losses by Individuals.—Subject to the limitations provided in subsection (r) of this section, in the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business;

(3) of property not connected with the trade or business, if the loss arises from fires, storms, shipwreck, or other casualty, or from theft. No loss shall be allowed as a deduction under this paragraph if at the time of the filing of the return such loss has been claimed as a deduction for estate tax purposes in the estate tax return.

(f) Losses by Corporations * * *; (g) Basis for Determining Loss * * *; (h) Loss on Wash Sales of Stock or Securities * * *; (i) Net Losses

* * *; (j) Bad Debts * * *; (k) Depreciation * * *; (l) Depletion * * *; (m) Basis for Depreciation and Depletion * * *;

(n) Charitable and Other Contributions.—In the case of an individual, contributions or gifts made within the taxable year to or for the use of: * * *

(2) A corporation, or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual: * * *

to an amount which in all the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this subsection. Such contributions or gifts shall be allowable as deductions only if verified under rules and regulations prescribed by the Commissioner, with the approval of the Secretary. (For unlimited deduction if contributions and gifts exceed 90 per centum of the net income, see section 120.) (Italics supplied.)

(o) Future Expenses in Case of Casual Sales of Real Property * * *; (p) Dividends Received by Corporations * * *; (q) Pension Trusts * * *;

(r) Limitation on Stock Losses.—

(1) Losses from sales or exchanges of stock and bonds (as defined in subsection (t) of this section) which are not capital assets (as defined in section 101) shall be allowed only to the extent of the gains from such sales or exchanges (including gains which may be derived by a taxpayer from the retirement of his own obligations.) * * *

(s) Same—Short Sales * * *; (t) Definition of Stocks and Bonds * * *

SUBTITLE C—SUPPLEMENTAL PROVISIONS

Supplement A—Rates of Tax

(Supplementary to Subtitle B, Part 1)

SEC. 101. CAPITAL NET GAINS AND LOSSES.

(a) Tax in case of capital net gain.—In the case of any taxpayer other than a corporation, who for any taxable year derives a capital net gain (as hereinafter defined in this section), there shall at the election of the taxpayer, be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: A partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total tax shall be this amount plus 12½ per centum of the capital net gain.

(b) Tax in case of capital net loss.—In the case of any taxpayer, other than a corporation, who for any taxable year sustains a capital net loss (as hereinafter defined in this section), there shall be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted, and the total tax shall be this amount minus 12½ per centum of the capital net loss but in no case shall the tax of a taxpayer who has sustained a capital net loss be less than the tax computed without regard to the provisions of this section.

(c) Definitions.—For the purposes of this title—

(1) "Capital gain" means taxable gain from

the sale or exchange of capital assets consummated after December 31, 1921.

(2) "Capital loss" means deductible loss resulting from the sale or exchange of capital assets.

(3) "Capital deductions" means such deductions as are allowed by section 23 for the purpose of computing net income, and are properly allocable to or chargeable against capital assets sold or exchanged during the taxable year.

(4) "Ordinary deductions" means the deductions allowed by section 23 other than capital losses and capital deductons.

(5) "Capital net gain" means the excess of the total amount of capital gain over the sum of (A) the capital deductions and capital losses, plus (B) the amount, if any, by which the ordinary deductions exceed the gross income computed without including capital gains.

(6) "Capital net loss" means the excess of the sum of the capital losses plus the capital deductions over the total amount of capital gain.

(7) "Ordinary net income" means the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions.

(8) "Capital assets" means property held by the taxpayer for more than two years (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business. * * *

(d) Collection and payment of tax.—The total tax determined under subsection (a) or (b) shall be collected and paid in the same manner at the same time, and subject to the same provisions of law, including penalties, as other taxes under this title.

JUDICIAL HISTORY OF THE CONTROVERSY

The judicial history of the controversy as to the measure of the base for the calculation of the 15 per cent limitation on the amount allowable as a deduction for charitable contributions where the taxpayer sustained a nondeductible *capital net loss* is covered by the following cases:

> *Elkins* v. *Commissioner*, 24 B.T.A. 572 (decided November 3, 1931) (NA) Cumulative Bulletin XI-1, p. 9; (A) Cumulative Bulletin XII-1, p. 4. Board Member Trussell, who prepared the opinion in this case during his term of office, did not participate in the later consideration of the same question, because of his death, which occurred on October 23, 1931.
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> *Livingood* v. *Commissioner*, 25 B.T.A. 585 (decided February 23, 1932) (NA) Cumulative Bulletin XI-1, p. 10; (A) Cumulative Bulletin XII-1, p. 8.
>
> *Lockhart* v. *Commissioner*, 32 B.T.A. 732 (decided June 10, 1935), affirmed (CCA 3) March 16, 1937, 89 F. (2d) 143, certiorari denied.
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> *Avery* v. *Commissioner*, 32 B.T.A. 948 (decided July 16, 1935), affirmed (CCA 7) June 30, 1936, 84 F (2d) 905, certiorari denied.

The fact that this Court denied certiorari in the *Avery* and *Lockhart* cases, supra, is not decisive of the question here presented for decision. As was well said by Mr. Justice Holmes speaking for the Court in *Atlantic Coast Line R. Co.* v. *Powe*, 283 U. S. 401, 403-404:

> "* * * But 'The denial of a writ of certiorari imports no expression of opinion upon the merits of the case, as the bar has been told many times.' United States v. Carver, 260 U. S. 482, 490, 67 L. ed. 361, 364, 43 S. Ct. 181."

This Court has not expressed its views on the precise point in issue in this case.

The question at issue is presently pending before the Third Circuit on petition for rehearing in *Howard Heinz* v. *Commissioner*, 34 B.T.A. 885 (decided August 7, 1936), affirmed (CCA 3) February 11, 1938, 94 F. (2d) 832, and before the same Circuit in *John E. Zimmerman* v. *Commissioner*, 36 B.T.A. 618 (decided October 7, 1937), on appeal from the Board's decision.

The same issue is also pending before the Eighth Circuit in *Watkins v. Commissioner, Moulton* v. *Commissioner* and *Johnson* v. *Commissioner*, on appeal from a memorandum decision of the Board of Tax Appeals.

This Court in *Helvering* v. *Bliss*, 293 U. S. 144, held that the base under Section 23 (n) for the calculation of the 15 per cent limitation on the amount deductible for charitable contributions, where the taxpayer's taxable *net income* consisted of both (1) ordinary net income subject to the normal and surtaxes under Sections 11 and 12, and (2) capital net gain taxed specially at 12½ per cent under Section 101 (a), was the total of the two parts as computed without the benefit of the deduction for contributions, and that the deduction for contributions was an *ordinary deduction* in the computation of the taxpayer's *ordinary net income*.

In the case at bar, the taxpayer's sole *net income* consists of ordinary net income, but the Commissioner of Internal Revenue refuses to permit a deduction for contributions in ascertaining that net income.

ARGUMENT

I

The base for calculating the 15 per cent limitation under Section 23 (n) on the amount allowable as a deduction for contributions is the taxpayer's taxable "net income," as computed without the benefit of the deduction, and not such net income diminished by a nondeductible capital net loss.

Congress adopted the term "net income," and prescribed the standards for its computation with a view to providing a readily ascertainable base for the calculation of the tax, and it is that base, as computed before the deduction for contributions is taken, which measures the 15 per cent limitation under Section 23 (n) on the amount allowable as a deduction for contributions. Article 261 of Regulations 77 under the 1932 Act dealing with the deductions for contributions is in harmony with the statute.

The respondent's taxable *net income* consists entirely of his *ordinary net income* of $94,963.52. (Fg. 4, R. 13.) The Commissioner treated it as the respondent's *net income* subject to tax under Sections 11 and 12 of the Revenue Act of 1932. While the Commissioner of Internal Revenue maintains that the respondent has a *net income* within the purview of that term as used in Sections 11 and 12 of $94,963.52 and levies a tax thereon, he contends that for the purpose of Section 23 (n) the respondent has a *net loss* of more than $59,000.00, which is produced by deducting the nondeductible *capital net loss* of $154,921.98 sustained by the respondent in the year 1932.

Congress originally introduced the capital net loss provisions by Section 208 of the Revenue Act of 1924, and were subsequently reenacted by Section 208 of the Revenue Act of 1926, and by Section 101 of the Rev-

enue Acts of 1928 and 1932. The Revenue Act of 1934 by Section 117 produced a change.

The Commissioner of Internal Revenue in the administration of the Revenue Acts of 1924, 1926, 1928 and 1932 has consistently held that a *capital net loss* was not a permissible deduction in the computation of net income subject to tax. This is a correct interpretation of the statute, and we do not challenge the same. Section 101 (c) (6) of the Revenue Act of 1932 provides as follows:

> "(6) 'Capital net loss' means the excess of the sum of the capital losses plus the capital deductions over the total amount of capital gain."

It means the *net loss* on the sale of assets held by a taxpayer for more than two years, and such net loss is not a permissible deduction in computing taxable net income.

The confusion which has heretofore existed on the question at issue resulted from a failure to recognize the difference between a deductible *capital loss*, as defined by Section 101 (c) (2), and a nondeductible *capital net loss*, as defined by Section 101 (c) (6). Section 101 (c) (2) defines a *capital loss* as follows:

> "(2) 'Capital loss' means deductible loss resulting from the sale or exchange of capital assets."

Capital losses are deductible from *capital gains* in ascertaining a *capital net gain*, as defined by Section 101 (c) (5), which is taxed specially at 12½ per cent. *Capital losses* are deductible to the extent of the *capital gains* in ascertaining a *capital net loss*. The excess of the *capital losses* over *capital gains* is a *capital net loss* which is excluded in the computation of the net income which is subjected to tax under the Act.

A *capital net loss* is the base under Section 101 (b)

for the allowance of a credit of 12½ per cent thereof against the normal and surtaxes levied on the taxable net income under Sections 11 and 12. If Congress had only allowed a credit of 1 per cent, the issue would still be the same. The *capital net loss* to the extent of 12½ per cent thereof was allowed as a credit against the normal and surtaxes, in the same manner as Sections 31 and 32 allow a credit against tax for foreign income and profits taxes, and taxes withheld at the source under Section 143. A *capital net loss* is excluded in the computation of taxable net income.

In *Piper* v. *Willcuts*, (CCA 8), 64 F. (2d) 813, affirming 55 F. (2d) 397, and *Hoffman* v. *Commissioner*, (CCA 2), 71 F. (2d) 929, it was expressly ruled that a loss of the character sustained by the respondent here constituted a *capital net loss*, which was not a permissible deduction. In *Piper* v. *Willcuts*, supra, Circuit Judge Van Valkenburgh, quoting from the trial judge, said:

> "The Commissioner of Internal Revenue determined a deficiency in the plaintiff's tax liability for the calendar year 1927 of $1,528.82, holding that the loss from the sale of the stock in question constituted a 'capital net loss' within the meaning of Section 208 (a) (6) of the Revenue Act of 1926 (title 26, USCA sec. 939 note), and that *it was therefore not a proper deduction from the plaintiff's gross income* * * *."

Piper sold 300 shares of stock of a certain company at a loss of $29,996.00, the said stock having been held by him for more than two years. Piper claimed a deduction for the *capital loss* on the ground that since he had no *capital gains*, the loss was not a *capital net loss* within the meaning of that term as used in Section 208 (a) (6) of the Revenue Act of 1926. The Court held that the loss constituted a *capital net loss* and therefore not deductible. The existence of a *capital gain* is not

a prerequisite to the existence of a *capital net loss.*

The loss in the case at bar is of a similar nature to that which existed in *Piper* v. *Willcuts*, supra. The respondent here sustained a loss of $154,921.00 on the sale of 19,482 shares of stock of a certain company which he held for more than two years. He had no *capital gains.* (R. 8.) Pleasants did not claim a deduction for the loss, and we do not challenge the correctness of the rule of *Piper* v. *Willcuts*, supra. The Commissioner of Internal Revenue recognizes that rule for all purposes, except Section 23 (n).

This Court in *Helvering* v. *Bliss*, supra, ruled that the base specified in Section 23 (n) was the taxpayer's total net income—the base for the calculation of the tax—as computed without the benefit of the deduction for contributions. In that case, Bliss had two different kinds of *net income* (1) net income consisting of ordinary net income subject to the normal and surtax rates under Sections 11 and 12, and (2) net income consisting of *capital net gain* taxed specially at 12½ per cent under Section 101 (a). This Court held that the total of the two parts constituted Bliss' *net income* within the meaning of that term as used in Section 23 (n). The Commissioner in the *Bliss* case contended that the 15 per cent limitation applied solely to *ordinary net income*, while the taxpayer maintained it applied to the entire net income. This Court held that the *capital net gain* existing in that case constituted a part of *net income.*

The *Bliss* case, while not controlling the case at bar because the issue here was not involved therein, does lend great aid in the solution of the present problem.

In the *Bliss* case, 293 U. S. 144, 146-147, this Court, speaking through Mr. Justice Roberts, said:

> "For 'net income,' the base specified in Section 23 (n) upon which the 15 per cent deduction of

> charitable contributions is to be calculated, the petitioner (Commissioner) would substitute 'ordinary net income' as defined in Section 101. So to read the Act would violate its plain terms and run counter to the history of the legislation."

The Commissioner places reliance on the above language to support his action in denying a deduction for contributions to the respondent here. The Commissioner is of the view that *net income* consisting of *ordinary net income* cannot be the base for the calculation of the 15 per cent limitation, yet this Court in the *Bliss* case recognized that such net income was part of the base.

The rule is that the language of any opinion is to be considered in the light of the facts of the particular case which was decided. In *Cohens* v. *Virginia*, 6 Wheat. 264, 399, 19 U. S., Chief Justice Marshall made the following pertinent observation:

> "It is a maxim not to be disregarded, that general expressions, in every opinion, are to be taken in connection with the case in which those expressions are used. If they go beyond the case, they may be respected, but ought not to control the judgment in a subsequent suit when the very point is presented for decision."

Also see *Webster* v. *Fall*, 266 U. S. 507, 511; *United States* v. *Anderson*, et al., 269 U. S. 422, 442; *United States* v. *Mitchell*, 271 U. S. 9, 14.

When the Commissioner in the *Bliss* case substituted *ordinary net income* for *net income*, the base specified in Section 23 (n), he pursued a course of action which was wholly improper. To illustrate the injustice of the Commissioner's view of the statute, in *Straus* v. *Commissioner*, 27 B. T. A. 1116, involving the same issue as in the *Bliss* case, affirmed 74 F. (2d) 470, on the authority of the *Bliss* case, the taxpayer in the year

1929 donated $144,695.04 to charity, but the Commissioner reduced the allowable deduction to $6,461.99. Straus had an *ordinary net income* of $43,079.90 and a *capital net gain* of $766,463.96, both as computed without the benefit of a deduction for contributions. The Commissioner maintained that Straus was only entitled to a deduction of $6,461.99, being 15 per cent of the taxpayer's ordinary net income, but upon final decision Straus received a deduction of $121,431.79, being 15 per cent of his entire net income as computed without the benefit of the deduction.

When the Commissioner substituted *ordinary net income* for *net income* under Section 23 (n) in a capital net gain case, his action was obviously wrong.

The Board in the *Straus* case, supra, holding that the 15 per cent limitation was to be calculated on the taxpayer's entire taxable net income, overruled its prior decisions in *Ralph W. Harbison*, 26 B. T. A. 896, *Susan Dwight Bliss*, 27 B. T. A. 205, and *Mary Colgate*, 27 B. T. A. 506, which held that the 15 per cent applied merely to net income consisting of ordinary net income. The *Harbison* and *Bliss* cases were subsequently decided by this Court, 293 U. S. 144. The Board in the *Straus* case, did not as suggested by the Government, overrule its decision in *Hallie D. Elkins*, 24 B. T. A. 572 and *Charles J. Livingood*, Executor, 25 B. T. A. 585, which permitted a deduction for contributions based on taxable net income where the taxpayer sustained a nondeductible *capital net loss*. The Board in the *Straus case*, 27 B. T. A. 1116, 1119, said:

> "* * * The cases involving capital net losses may or may not be distinguished from those involving capital net gains. We express no opinion on that subject, but confine ourselves strictly to the question before us. * * *."

In the case at bar, the respondent's net income con-

sists solely of his *ordinary net income* of $94,963.52. This was his taxable net income as computed before any deduction for charitable contributions, and was so found by the Court below. (Fdg. 4, R. 13.) The Commissioner in the computation of the said net income of $94,963.52 did *not* allow any deduction for the respondent's *capital net loss* of $154,921.98, because a capital net loss is not a permissible deduction in computing net income subject to tax. This is a correct interpretation of the statute. The Commissioner employed the said sum of $94,963.52 as the respondent's final net income—the base for the calculation of the tax under Sections 11 and 12, and then allowed as a credit against the taxes thus determined 12½ per cent of the capital net loss pursuant to Section 101 (b). The Commissioner held, however, that the respondent had no "net income," for the purpose of Section 23 (n).

For *net income*, the base specified in Section 23 (n), the Commissioner would now substitute a *net loss* of more than $59,000.00 by deducting the nondeductible *capital net loss* from the respondent's taxable net income. In our view of the statute, a taxpayer has a base under Section 23 (n) if he has a net income subject to tax.

This Court in the Bliss case, 294 U. S. 144, 147, further said:

> "The scheme of all the Revenue Acts since that of 1916 has been to sweep all income of every sort, including capital gains, into what is denominated gross income and to authorize certain deductions therefrom in order to arrive at net income—*the base for calculation of the tax.* In the Act of October 3, 1917, Congress, in order to encourage gifts to religious, educational and other charitable objects, granted the privilege of deducting such gifts from gross income, but limited the total deduction to 15 per cent of the taxpayer's net income, calculated in the first in-

> stance without reference to the amount of such contributions. All of the later Acts have contained a like provision. The Acts provide that the taxpayer shall first deduct from gross income the total of all permissible deductions save that for contributions, thus arriving at a provisional net income, and then deduct therefrom his contributions, but in no event to an amount greater than fifteen per cent of the provisional net income. By the last mentioned operation the final net income—*the base for calculation of the tax*—is ascertained. * * *." (Italics supplied.)

The above is an excellent statement of the applicable law, and applies with equal force here.

The respondent here had a gross income of $96,702.67. The total of his permissible deductions save that for contributions was $1,739.15. His provisional net income was $94,963.52. (R. 7-8.) If respondent is entitled to a deduction for his contributions of $3,496.00, his final net income is $91,467.52. The Commissioner treated $94,963.52 as the respondent's final net income—the base for calculation of the tax—under Sections 11 and 12, but for *net income*, the base specified in Section 23 (n), he substituted a *net loss* of more than $59,000.00. So to read the Act also violates its plain terms and runs counter to the history of the legislation. It nullifies and defeats the beneficent purpose of Section 23 (n) to encourage contributions to charitable institutions. Congress intended to give taxpayers a saving in tax if they donated to charity. The Commissioner by his action in this case thwarts that policy.

This case affects that class of taxpayers who were benevolently minded and contributed substantial sums to charitable institutions notwithstanding their own financial misfortune. The injustice of the Commis-

sioner's position is illustrated by the following example:

TAXPAYER "A"

INCOME

Item and Instruction No.			
1.	Salaries	$ 50,000.00	
3.	Interest	10,000.00	
7.	Rents and Royalties	440,000.00	
12.	Total Income		$500,000.00

DEDUCTIONS

13.	Interest Paid	$10,000.00	
14.	Taxes Paid	40,000.00	
17.	Contributions	50,000.00	
19.	Total Deductions		100,000.00
20.	Net Income		$400,000.00
22.	Net Income for Tax Computation		$400,000.00
	COMPUTATION OF TAX (See Instruction 23)		
23.	Net Income Subject to Tax		$400,000.00
26.	Less, Personal Exemption		2,500.00
29.	Balance Subject to Normal Tax		$397,500.00
30.	Amount taxable at 4%		$ 4,000.00
31.	Amount taxable at 8%		$393,500.00
32.	Amount of Capital Net Gain or Loss (From Schedule D)	(loss)	$550,000.00
33.	Normal Tax (4% of Item 30)		160.00
34.	Normal Tax (8% of Item 31)		31,480.00
35.	Surtax on Item 22		171,960.00
36.	Tax on Net Income (total of Items 33 to 35)		$203,600.00
37.	Adjustment for Capital Gain or Loss (12½% of Item 32)		68,750.00
38.	Total Tax (total of or difference between Items 36 and 37)		$134,850.00

In the foregoing example, TAXPAYER "A," in the year 1932 donated $50,000.00 to charitable institutions. He reported a "net income," within the meaning of that term as used in Sections 11 and 12 of $400,000.00 after deducting contributions, and a "capital net loss," within the meaning of that term as used in Section 101 (c) (6) of $550,000.00. His normal and surtaxes under Sections 11 and 12 on his "net income," of $400,000.00 were shown to be

$203,600.00, against which he applied a credit of $68,750.00 representing 12½% of his capital net loss of $550,000.00. He reported the difference, or $134,850.00, as the total tax due.

Now, what happens in the case of TAXPAYER "A"? The Commissioner of Internal Revenue after an audit of TAXPAYER "A's" return would issue to him a notice of deficiency in tax disallowing in its entirety the deduction of $50,000.00 for contributions, because his capital net loss of $550,000.00 exceeded his "net income," subject to the normal and surtaxes imposed by Sections 11 and 12. According to the Commissioner of Internal Revenue TAXPAYER "A," has no "net income," within the contemplation of that term as used in Section 23 (n), because the base for the allowance of contributions where the taxpayer sustained a capital net loss, which is excluded in the computation of "net income," subject to the normal and surtaxes imposed by Sections 11 and 12, is "ordinary net income," as defined by Section 101 (c) (7), minus "capital net loss," as defined by Section 101 (c) (6). TAXPAYER "A," is thereby deprived of a deduction for contributions. Must TAXPAYER "A," under the facts of his case surrender his deduction for contributions? The denial of the deduction for contributions in his case would produce a deficiency in tax of $30,000.00, but the beneficent purpose of Congress in the enactment of Section 23 (n) is wholly defeated. Is this in accordance with the Congressional will and purpose? If so, what language in the Act compels such an absurdity? While the Commissioner's interpretation of the term "net income," as used in Section 23 (n) inflicts a more serious injury to TAXPAYER "A," than to the respondent here, the principle is the same. The two cases are precisely parallel in law. In both cases the base for the allowance of contributions is lost according to the Commis-

sion because the capital net loss exceeds the net income subject to the normal and surtaxes.

Does TAXPAYER "A," have to pay a tax of $164,-850.00 on taxable net income, and yet have no base under Section 23 (n) for the allowance of a deduction for contributions? For "net income," the base specified in Section 23 (n), the Commissioner would substitute a net loss of $100,000, as computed without the benefit of a deduction for contributions. The *base for calculation of the tax* in the case of TAXPAYER "A," is not a net loss of $100,000.00. If it were, no tax would be payable.

We contend that TAXPAYER "A's" "net income," as computed without the benefit of the deduction for contributions was $450,000.00, consisting of total income of $500,000 minus $50,000, representing interest and taxes paid, and we earnestly maintain that the respondent's "net income," as aforesaid for the year 1932, was $94,963.52. In both cases the amounts deducted for contributions were within the 15% limitation prescribed by Section 23 (n).

In the case of *John E. Zimmermann* v. *Commissioner*, 36 B. T. A. 618, presently pending before the Third Circuit on appeal from the Board's decision, the Commissioner is claiming a deficiency in income tax of $11,632.23 on Zimmermann's *net income* consisting of ordinary net income of $129,434.81 as computed without the benefit of a deduction for contributions. Zimmermann claimed a deduction of $17,178.64 for contributions to charity, but the Commissioner denied the deduction in its entirety, because Zimmermann sustained a *capital net loss* of $267,252.87, which exceeded his taxable net income.

Did Congress by the adoption of the capital net loss provisions of Section 101 intend to invade Section 23 (n) and impair or destroy the deduction for con-

tributions in a case where the taxpayer had a net income subject to tax, and paid an income tax? Is such a taxpayer to lose his deduction for contributions in the process of losing a deduction for a net loss sustained from the sale of investment property held for more than two years, which is denominated a "capital net loss," by Section 101 (c) (6)? We fail to find any language in the Act, or any legislative history, which evinces any such incongruous purpose. To our minds, Section 101 displays careful legislative draftsmanship, and the provisions thereof dovetail well with the balance of the Act when given a fair and reasonable interpretation consistent with the legislative purpose.

To illustrate further the destructive effect on the deduction for contributions produced by attributing to the term *net income* as used in Section 23 (n) the meaning taxable net income less the nondeductible capital net loss:

TAXPAYER "B"

INCOME

Item and Instruction No.*			
2.	Income from Business or Profession	$175,000.00	
8.	Profit from Sale of Real Estate, Stocks, Bonds, etc. (from Schedule C)	25,000.00 (loss)	
10.	Dividends	25,000.00	
12.	Total Income		$175,000.00

DEDUCTIONS

14.	Taxes Paid	1,500.00	
17.	Contributions	15,000.00	
19.	Total Deductions		16,500.00
20.	Net Income		$158,500.00
22.	Net Income for Tax Computation		$158,500.00
	COMPUTATION OF TAX (See Instruction 23)		
23.	Net Income Subject to Tax		$158,500.00
25.	Less Dividends	$25,000.00	
26.	Personal Exemption	2,500.00	
28.	Total of Items 24 to 27		27,500.00
29.	Balance subject to Normal Tax (Item 23 minus Item 28)		$131,000.00
30.	Amount taxable at 4%		4,000.00
31.	Amount taxable at 8%		$127,000.00
32.	Amount of Capital Net Gain or Loss (From Schedule D)	(loss)	$125,000.00
33.	Normal Tax (4% of line 30)		$ 160.00
34.	Normal Tax (8% of line 31)		$ 10,160.00
35.	Surtax on Item 22		$ 50,625.00
36.	Tax on Net Income (total of Items 33 to 35)		$ 60,945.00
37.	Adjustment for Capital Gain or Loss (12½% of Item 32)		15,625.00
38.	Total Tax (difference between lines 36 and 37		$ 45,320.00

*Please see the specimen return and instructions, Form 1040, for the calendar year 1932 appearing at pages 22,968-22,979, Prentice-Hall Tax Service, 1933.

In the above example, TAXPAYER "B," in the year 1932 contributed $15,000.00 to charitable institutions. He reported a "net income," within the meaning of that term as used in Sections 11 and 12 of $158,500.00 after deducting contributions, and a "capital net loss," within the meaning of that term as used in Section 101 (c) (6) of $125,000.00. His normal and surtaxes under Sections 11 and 12 on his "net income," of $158,500.00 were shown to be $60,945.00, against which he applied a credit of $15,625.00, representing 12½% of

his capital net loss of $125,000.00. He reported the difference, or $45,320.00, as the total tax due.

Now, what happens in the case of TAXPAYER "B?" He would also receive a deficiency notice from the Commissioner of Internal Revenue. While he would not suffer the misfortune of losing his deduction for contributions entirely, it would be cut down materially. In the Commissioner's view, TAXPAYER "B's" "net income," within the contemplation of that term as used in Section 23 (n) as computed without the benefit of the deduction for contributions, was $48,500.00, consisting of "ordinary net income," of $173,500.00 without the deduction, reduced by the "capital net loss," of $125,000.00. TAXPAYER "B," would be granted a deduction of $7,275.00, being 15% of $48,500.00, in lieu of the claimed deduction of $15,000.00. The balance of contributions in the amount of $7,725.00 would be disallowed because it exceeded the 15% limitation, and the Commissioner would claim a deficiency in tax of $4,403.25.

For "net income," the base specified in Section 23 (n), the Commissioner would substitute $48,500.00, the taxable net income less the nondeductible capital net loss. The sum of $48,500.00 is not the *base for the calculation of the tax*. If it were, TAXPAYER "B," would not have to pay a tax of $45,320.00.

In the case of *Howard Heinz* v. *Commissioner*, 34 B. T. A. 885, affirmed (CCA 3) February 11, 1938, 94 F. (2d) 832, now pending before the Third Circuit on petition for rehearing, Heinz in the year 1931 contributed $45,910.37 to charity, but the Commissioner reduced the allowable deduction to $28,031.86, and in the year 1932 Heinz contributed $51,571.40 to charity, but the Commissioner reduced the deduction to $4,-987.64. Heinz's net income subject to tax under Section 12 for 1931, as computed without the deduction

for contributions, was $375,844.65. Heinz paid an income tax of $25,302.90 for 1931, and the Commissioner claims a deficiency in tax of $11,428.86 for that year. Heinz sustained a nondeductible capital net loss of $186,879.09 in 1931. Heinz's net income subject to tax under Sections 11 and 12 for 1932, as computed before the deduction for contributions, was $412,017.69. Heinz paid an income tax of $108,842.23 for 1932, and the Commissioner claims a deficiency in tax of $22,633.73 for that year. Heinz sustained a nondeductible capital net loss of $378,766.79 in 1932.

The *Heinz* case was tried on a stipulation of facts which was confusing. (R. 23.) It read in part as follows:

> "10. The petitioner's taxable net income for the year 1931, as reflected by the notice of deficiency for that year (before the allowance of any deduction for contributions pursuant to Section 23 (n) of the Revenue Act of 1928) is $186,879.09. Said amount of $186,879.09 consists of ordinary net income in the amount of $375,844.65 and capital net loss in the amount of $186,965.56.
> * * *
>
> "13. In his income tax return for the year 1931, the petitioner claimed a deduction as and for contributions in the amount of $45,910.37. In arriving at the deficiency involved for the year 1931, the respondent determined the petitioner's allowable deduction for contributions for that year to be $28,031.86 (15 % of $186,879.09 equals $28,031.86).
>
> "14. The petitioner's taxable net income for the year 1932, as reflected by the notice of deficiency for that year (before the allowance of any deduction for contributions pursuant to Section 23 (n) of the Revenue Act of 1932) is $33,250.90. Said amount of $33,250.90 consists of ordinary net income in the amount of $412,017.69 and capital net loss of $378,766.79.
> * * *

"17. In his income tax return for the year 1932, the petitioner claimed a deduction as and for contributions in the amount of $51,571.40. In arriving at the deficiency involved for the year 1932, the respondent determined the petitioner's allowable deduction for contributions for that year to be $4,987.64 (15% of $33,250.09 equals $4,987.64)."

How can the Commissioner consistently hold that the total tax assessable against Heinz for 1932 on his taxable net income is $131,476.06, of which Heinz previously paid $108,842.23, and at the same time hold that for the purpose of Section 23 (n) his "net income," is only $33,250.09? The said sum of $33,250.09 is not the base under the Act for the *calculation of the tax.* If it were, it would not produce a tax liability of $131,476.06. The Commissioner did not allow Heinz any deduction for his *capital net loss* in computing his net income subject to tax under Sections 11 and 12. A capital net loss serves as the base for the allowance of a credit of 12½% per cent thereof against the normal and surtaxs, not as a deduction from gross income.

Board Member Sternhagen, who announced the opinion of the full Board in the *Heinz* case, supra, 34 B. T. A. 885, 900 (decided August 7, 1936), made the following pertinent observation:

> "In the instant case it will be seen that the capital loss provision indirectly works to the petitioner's advantage, when read in conjunction with the provision for deducting charitable contributions, for while the former section limits the amount of losses to the petitioner's disadvantage, it increases the amount of his total net income, and to that extent, therefore, enlarges the charitable deduction which is measured by a percentage of that income. The ameliorative purpose of the two sections is therefore retained here. And there is nothing in the Bliss decision which warwants going farther."

The above language supports the taxpayer's view of the statute. The exclusion of the capital net loss as required by the statute without question serves to increase the amount of a taxpayer's total net income and to enlarge the base for the calculation of the 15 per cent limitation which is measured by a percentage of that net income. This is precisely what we contend. When the tax was recomputed in the *Heinz* case under Rule 50 of the Board's rules of practice, however, the deduction for contributions was based on a net income decreased by the capital net loss.

A stipulation which attempts to resolve a controverted issue of law is not binding on a Court. In *Swift & Co.* v. *Hocking Valley R. Co.*, 243 U. S. 281, 289, Mr. Justice Brandeis, speaking for the Court, said:

> "If the stipulation is to be treated as an agreement concerning the legal effect of admitted facts, it is obviously inoperative; since the court cannot be controlled by agreement of counsel on a subsidiary question of law. See cases cited in margin. If the stipulation is to be treated as an attempt to agree 'for the purpose only of reviewing the judgment' below, that what are the facts shall be assumed not to be facts, a moot or fictitious case is presented. 'The duty of this court, as of every judicial tribunal, is limited to determining rights of persons or of property, which are actually controverted in the particular case before it * * * No stipulation of parties or counsel, whether in the case before the court or in any other case, can enlarge the power, or affect the duty, of the court in this regard.' *California* v. *San Pablo & T. R. Co.*, 149 U. S. 308, 314, 37 L. ed. 747, 748, 13 Sup. Ct. Rep. 876. See *Mills* v. *Green*, 159 U. S. 651, 654, 40 L. ed. 293, 294, 16 Sup. Ct. Rep. 132. The fact that effect was given to the stipulation by the appellate courts of Ohio does not conclude this court. See *Tyler v. Judges of Ct. of Registration*, 179 U. S. 405, 410, 45 L.

ed. 252, 254, 21 Sup. Ct. Rep. 206. We treat the stipulation, therefore, as a nullity."

The Third Circuit in the *Heinz* case, 94 F. (2d) 832, 833, said in part as follows:

> "The sole question here raised is whether the deductions allowed for charitable contributions shall be measured by a percentage of the net income or income before *capital losses* are deducted. * * *."

That was not a correct statement of the issue. The question is whether in determining the base for the calculation of the 15 per cent limitation, a *capital net loss*, as defined by Section 101 (c) (6), not a *capital loss*, as defined by Section 101 (c) (2), was to be treated as a permissible deduction. In other words, is the base to be reduced by the *capital net loss?* A *capital loss* as defined by Section 101 (c) (2) is deductible from a *capital gain* as defined by Section 101 (c) (1) in computing *capital net gain* as defined by Section 101 (c) (5). A *capital net loss* as defined by Section 101 (c) (6) is the excess of the sum of the capital losses plus capital deductions over the total amount of capital gain. In other words, it is the net loss on the sale of assets held by a taxpayer for more than two years denominated by Section 101 (c) (8) as *capital assets*, and by the express language of Section 101 (c) (7) such net loss was excluded in arriving at the *net income* which was to be taxed at the normal and surtax rates under Sections 11 and 12. That section also requires the exclusion of a capital net gain. The ordinary net income is the net income to be taxed under Sections 11 and 12, and the capital net gain is the net income to be taxed at 12½ per cent under Section 101 (a). In the case at bar the taxpayer's sole net income was his ordinary net income.

In *Lockhart* v. *Commissioner*, 32 B. T. A. 732, affirmed (CCA 3), 89 F. (2d) 143, the stipulation of facts provided in part as follows:

> "1. Petitioner's taxable net income for the year 1929 (before the allowance of any deduction for contributions pursuant to Section 23 (n) of the Revenue Act of 1928) is $911,599.10.
>
> "2. Said amount of $911,599.10 consists of ordinary income in the amount of $966,467.20 and capital net loss in the amount of $54,868.10.
>
> "3. During the year 1929 petitioner made contributions or gifts to the persons and organizations specified and described in Section 23 (n) of the Revenue Act of 1928 in the total amount of at least $144,970.08.
>
> * * *
>
> "5. The deduction for contributions claimed in petitioner's income tax return for the year 1929 was $131,200.84. The deduction for contributions allowed by the Commissioner in determining the deficiency was $202,162.06. The Commissioner contends that the amount of petitioner's allowable deduction for contributions is $136,739.87, viz. 15% of $911,599.10. Petitioner contends that the entire amount of $144,970.08, viz., 15% of $966,467.20, is allowable as a deduction in computing his ordinary net income subject to normal and surtaxes."

The capital net loss in that case was not treated by the Commissioner as a permissible deduction in computing the net income subject to the normal and surtaxes imposed by Sections 11 and 12.

In the Government's brief in this case reference is made to I. T. 2104, Cumulative Bulletin III-2, page 152, as supporting the conclusion that a *capital net loss* should not be excluded in computing the net income contemplated by Section 23 (n). The Commissioner by his action in the respondent's case did exclude it in computing the net income contemplated by Sections 21,

22 and 23, and Sections 11 and 12. I. T. 2104 did not hold that a *capital net loss* is a permissible deduction in computing net income. It held that *capital losses* are deductible. Capital losses are deductible to the extent of the capital gains, but the excess of such losses over gains is a *capital net loss* which is not a permissible deduction. This Court in the *Bliss* case prefixed its reference to the Bureau rulings by the word "See." This was perfectly proper, and implies no approval of I. T. 2104. This ruling provides in part as follows:

> "Advice is requested as to whether capital losses may be excluded in determining net income for the purpose of computing the amount of charitable contributions allowable as deductions under the Revenue Acts of 1918, 1921, and 1924. * * * "Inasmuch as losses resulting from the sale or exchange of capital assets are deductible under section 214 of the Revenue Acts of 1918, 1921, and 1924, and enter into the computation of the net loss that is deductible under section 206 of the Revenue Act of 1924, it follows that such losses can not be excluded in computing the net income for the purpose of determining the amount of charitable contributions that are deductible under section 214 (a) 11 of the Revenue Acts of 1918 and 1921 and section 214 (a) 10 of the Revenue Act of 1924."

This ruling does not hold, as suggested by the petitioner that a "capital net loss" must be subtracted from "ordinary net income," as computed without a deduction for contributions, in arriving at the base for calculation of the 15% limitation. There is quite a distinction between a "capital loss," and a "capital net loss." See Section 208 (a) (2) and (6), Revenue Act of 1924, and Section 101 (c) (2) and (6), Revenue Act of 1932. A "capital net loss" is not a permissible deduction in computing a "net loss," 7

which is to be carried forward to a subsequent taxable year, and if I. T. 2104 so holds by implication, it is void, as being contrary to law.

Section 206 (a) of the Revenue Act of 1924 provides in part as follows:

> "Sec. 206. (a) As used in this section the term 'net loss' means the excess of the deductions allowed by section 214 or 234 over the gross income, with the following exceptions and limitations: * * *—
>
> "(2) In the case of a taxpayer other than a corporation, deductions for capital losses otherwise allowed by law shall be allowed only to the extent of the capital gains; * * *."

The law is the same under the Revenue Act of 1932 which controls the instant case. See Sections 23 (i) and 117 (a) (2), Revenue Act of 1932.

If a *capital net loss* is a permissible deduction in computing net income, why was it that the Commissioner did not allow it as such in computing the respondent's net income subject to tax? A capital loss is a permissible deduction under certain circumstances. Capital losses are deductible from capital gains in ascertaining a capital net gain. Capital losses are deductible to the extent of capital gains, but the excess of such losses over gains is a capital net loss, which is not a permissible deduction.

I. T. 2104 is a correct ruling as applied to deductible capital losses. It does not hold that a capital net loss is deductible, and the Commissioner in the administration of Section 206 (a) of the Revenue Act of 1924 has never allowed a capital net loss—the excess of capital losses over gains—as a deduction in computing a net loss to be deducted in a succeeding taxable year. So to construe the statute would contravene Section 206 (a) (2). Section 117 (a) (7) of the Revenue Act of 1932 similarly limits the deduction of capital losses.

The Revenue Act of 1932 by Section 23 (r) (1) limited the deduction of losses on the sale or exchange of noncapital assets to the amount of the gains. To illustrate, if a taxpayer had gains of $10,000.00 and losses of $50,000.00, the gains of $10,000.00 are includable in gross income, and the deduction for losses is limited to $10,000.00. The excess of the losses over gains, or $40,000.00, is not a permissible deduction. Section 23 (r) (1) of the 1932 Act provided as follows:

> "(r) Limitation on Stock Losses.—
>
> "(1) Losses from sales or exchanges of stocks and bonds (as defined in subsection (t) of this section) which are not capital assets (as defined in section 101) shall be allowed only to the extent of the gains from such sales or exchanges (including gains which may be derived by a taxpayer from the retirement of his own obligations)."

Section 23 (r) (2) providing for the deduction in a succeeding taxable year of the disallowed loss under Section 23 (r) (1) was repealed by Section 218 (b) of the National Industrial Recovery Act, approved June 16, 1933.

While the administrative practice of the Commissioner under the Revenue Acts of 1924, 1926, 1928 and 1932 has been uniform in holding that a *capital net loss* was not a permissible deduction in computing net income subject to tax, or in computing a net loss for carryover purposes, his practice of decreasing taxable net income by a nondeductible capital net loss for the purpose of Section 23 (n) has been one of inconsistency of long standing. The Revenue Act of 1924 introduced the capital net loss provisions. The full Board disapproved the practice of deducting a nondeductible capital net loss in *Hallie D. Elkins*, 24 B. T. A. 572 (decided November 3, 1931). This was the first case

to be decided by the Board wherein the administrative practice was shown. Then subsequently *Charles J. Livingood*, 25 B. T. A. 585 (decided February 23, 1932) also held in favor of the taxpayer on the same issue. The Commissioner did not appeal from those decisions. Cumulative Bulletin XI-2, July-December, 1932, p. 3, shows the Commissioner's acquiescence in the decision of the Board in the *Elkins* case. Cumulative Bulletin XIII-2, July-December, 1934, p. 25 reports a subsequent nonacquiescence.

Under the Revenue Act of 1934 and subsequent Acts, certain percentages of gain or loss are recognized on the sale or exchange of capital assets, dependent on the length of time the assets were held. Where there is an excess of recognized losses over recognized gains, the deduction for losses is limited to $2,000.00, and the balance is disallowed in the same manner as a "capital net loss," is disallowed under the Revenue Act of 1932. See Section 117, Revenue Act of 1934.

The Commissioner in the instant case recognizes that a capital net loss is not a permissible deduction in ascertaining the net income for the imposition of the tax, but refuses to apply the same rule in administering Section 23 (n).

This Court in the *Bliss* case recognized that *net income* consisting of *ordinary net income* is part of the base specified in Section 23 (n). The respondent here has an *ordinary net income* and since it constitutes his sole net income, it constitutes the base for the purpose of Section 23 (n). A capital net loss is not a part of taxable net income, and is not a permissible deduction in computing the same. It is not the base for the calculation of the tax. It is the base for the calculation of a credit against tax.

This Court in the *Bliss* case, 293 U. S. 144, 148-150, further said:

> "Commencing with the Revenue Act of 1921 Congress, in order to encourage realization of profits on capital assets, saw fit to relieve gain thus derived of the heavy surtaxes then applicable, and to permit the payment of tax at a flat rate of 12½ per cent on so much of the taxpayer's income as represented the net gain from capital transactions.
>
> "The accomplishment of this purpose of applying two rates to two different kinds of net income, required new provisions as to the base for each rate. Section 101 of the Revenue Act of 1928 prescribes the method to be followed. * * * In extending this relief to taxpayers, Congress might have modified the privilege theretofore existing with respect to charitable contributions, by directing that they should be deducted solely from capital net gain or should be apportioned and deducted ratably from ordinary net income and from capital net gain. The Acts, however, evince no such purpose. In the Act of 1928, as will be seen by reference to Sections 21, 22 and 23 the statutory concept of net income is preserved. These sections are found in part II of title I, which deals with 'Computation of Net Income.' Section 101, on the other hand, is found under 'Supplemental Provisions,' and is captioned 'Supplement A-Rates of Tax.' It is obviously directed to the matter of computation of tax on a portion of net income as defined in Section 21. There is nothing novel in such a division of the statutory net income into parts for the purpose of applying different rates of tax * * *."

The statutory net income in the *Bliss* case comprised two parts (1) net income consisting of ordinary net income subject to tax under Sections 11 and 12, and (2) net income consisting of

capital net gain taxed specially at $12\frac{1}{2}$ per cent under Section 101 (a). The entire taxable net income consisting of a total of the two parts was held to constitute the base specified in Section 23 (n) for calculating the 15 per cent limitation in the *Bliss* case.

The respondent's net income consisting of ordinary net income of $94,963.52 was his entire taxable net income. It was his net income within the meaning of Sections 21, 22 and 23, otherwise it could not have been taxed as net income under Sections 11 and 12. These sections levy a tax on net income. While Sections 21, 22 and 23 govern principally the determination of statutory net income—the base for calculation of the tax—Sections 24, 41-48, 101 (5), 101 (7), 111, 112, 113, 114, 115, 116, 117, 118, 120 and others do affect its computation.

The *Bliss* case recognized that ordinary net income was net income within the meaning of Section 21, otherwise it could not have formed part of net income—the base specified in Section 23 (n). In the *Bliss* case this Court employed ordinary net income as part of the base under Section 23 (n).

This Court in the *Bliss* case, 293 U. S. 144, 150, further said:

> "The plain requirements of Section 101 are that in ascertaining ordinary net income there shall be excluded from the computation only items of capital gain, capital loss and capital deductions. Charitable contributions covered by Section 23 (n) obviously are not capital deductions as defined by Section 101 (c) (3), but on the contrary are 'ordinary deductions' within the meaning of Section 101 (c) (4).
>
> "By the express words of Section 23 (n) charitable contributions are to be deducted to ascertain net income as defined in Section 21; and nothing in Section 101, which prescribes merely a method for segregating a portion of that net

income for taxation at a special rate, in any wise, alters the right of the taxpayer to take the deduction in accordance with Section 23 (n)."

Section 101 (c) (7) provided as follows:

"(7) 'Ordinary net income' means the *net income*, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions."

This section denominates ordinary net income as net income. The language, "computed in accordance with the provisions of this title," obviously means in accordance with Sections 21, 22 and 23, because they were part of "this title," being Title I. The language of exclusion, "after excluding all items of capital gain, capital loss, and capital deductions," embrace either a capital net gain or capital net loss. The language of exclusion, however, does not require the exclusion of the ordinary deduction for contributions. This Court recognized that the deduction for contributions was an ordinary deduction in the computation of the taxpayer's ordinary net income. We earnestly maintain that the respondent here is entitled to a deduction for contributions in ascertaining his ordinary net income in the same manner as *Bliss* was accorded such a deduction in computing her ordinary net income. The Act prescribes one method of ascertaining ordinary net income, regardless of whether the taxpayer enjoys a capital net gain, or suffers a capital net loss. The Act did not contemplate discrimination in the ascertainment of ordinary net income.

This Court in the *Bliss* case, 293 U. S. 144, 150-151, further said:

"If the meaning of the Act were doubtful, we should still reach the same conclusion. The exemption of income devoted to charity and the

> reduction of the rate of tax on capital gains were liberalizations of the law in the taxpayer's favor, were begotten from motives of public policy, and are not to be narrowly construed. Nor should the reduction in the rate of tax on capital gain, first granted in the Revenue Act of 1921, be held to circumscribe the privilege granted in the earlier Acts, and retained in the later ones, with respect to charitable contributions, unless that result be plainly required by the language used. As has been shown the statutes if read as written lead to a contrary result. Moreover, from 1923 to 1932 the Commissioner uniformly ruled that the deduction for charitable contributions was to be taken from net income before computation of the tax and hence in whole from ordinary net income. The reenactment in later Acts of the sections permitting the deduction indicates Congressional approval of this administrative interpretation."

The respondent here is similarly entitled to a deduction for his contributions before computation of the tax, and in whole from his ordinary net income, which which was his sole net income. The only exception to the rule that the deduction for contributions must be taken in whole from ordinary net income is found in *Straus* v. *Commissioner*, 27 B. T. A. 1116, affirmed 74 F. (2d) 470, when the ordinary deductions, including the deduction for contributions, exceed the ordinary income. In such a case, the excess by the express language of Section 101 (c) (5) is deducted from the capital net gain, and the balance is subjected to the 12½ per cent rate. (See Report No. 179, p. 19, 68th Cong., 1st Sess., House Ways and Means Committee, covering the Revenue Bill of 1924.)

II

The design of Congress in the enactment of Section 23 (n), authorizing a deduction for charitable contributions, was to encourage taxpayers to make such contributions, and the Act should therefore be construed so as to effectuate that policy.

The provision permitting a deduction for contributions was originally incorporated in the Revenue Act of 1917. Section 1201 (2) of that Act, amending the Act of 1916, provided in part as follows:

> "(2) That section five of such Act of September eighth, nineteen hundred and sixteen, is hereby amended by adding at the end of subdivision (a) a further paragraph, numbered nine, to read as follows:
>
> " 'Ninth. Contributions or gifts actually made within the year * * * *to an amount not in excess of fifteen per centum of the taxpayer's taxable net income as computed without the benefit of this paragraph* * * * .' " (Italics supplied.)

The Revenue Acts of 1918, 1921, 1924, 1926, 1928, 1932, 1934, 1936 and 1938 similarly permitted a deduction for charitable contributions to an amount not in excess of 15% of the taxpayer's net income as computed without the benefit of the deduction, thus plainly evincing a continual legislative policy of encouraging taxpayers to sustain the charitable institutions of this country. This legislation has served a useful, beneficent purpose, and it works when given a proper interpretation.

The beneficent purpose of the deduction for charitable contributions was recognized in *Young Men's Christian Association* v. *Davis*, 264 U. S. 47, 50, *Old Colony Trust Co.* v. *Commissioner*, 301 U. S. 379, 384 and *Helvering* v. *Bliss*, supra.

Congress intended by Section 23 (n) to free from

tax an amount of taxable net income equal to the amount of the contributions within the limit of 15 per cent of such net income. In this way, a taxpayer donating to charity effected a saving in tax, but the Commissioner has denied the respondent here the benefit of the same.

The statute as construed by the Commissioner produces a positive repugnancy between the term "net income," as used in Section 23 (n), and the same term as used in other parts of the Act, with absurd consequences. This should be avoided unless the statute plainly requires it.

In *Bernier v. Bernier*, 147 U. S. 242, 246, Mr. Justice Field, who delivered the opinion of the Court, said:

> "* * All acts of the legislature should be so construed, if practicable, that one section will not defeat or destroy another, but explain and support it. When a provision admits of more than one construction, that one will be adopted which best serves to carry out the purposes of the act * * *."

The case of *U. S.* v. *Freeman*, 3 Howard 556, 44 U. S. also contains an excellent expression on this subject. Mr. Justice Wayne, who announced the opinion of the Court said:

> " * * * In 4 Dall. 14, 'The intention of the Legislature, when discovered, must prevail, any rule of construction declared by previous acts to the contrary notwithstanding.' In 2 Cranch, 33, (A law is the best expositor of itself—that every part of an act is to be taken into view for the purpose of discovering the mind of the Legislature,' etc. In the case of The United States v. Fisher et al., Assignees of Blight, in the same book, the court said, 'It is undoubtedly a well established principle in the exposition of statutes,

that every part is to be considered, and the intention of the Legislature to be extracted from the whole.' In 2 Peters, 662, 'A legislative act is to be interpreted according to the intention of the Legislature, apparent upon its face. Every technical rule, as to the construction or force of particular terms, must yield to the clear expression of the paramount will of the Legislature.' In Paine's C. C. Rep. 11, 'In doubtful cases, a court should compare all the parts of a statute, and different statutes in pari materia, to ascertain the intention of the legislature.' So in 1 Brockenb, C. C. Rep., 162. In the construction of statutes, one part must be construed by another. In order to test the legislative intention, the whole statute must be inspected * * *."

In *Ozawa* v. *U. S.*, 260 U. S. 178, 194, this Court, speaking through Mr. Justice Sutherland, said:

"It is the duty of this court to give effect to the intent of Congress. Primarily this intent is ascertained by giving the words their natural significance; but if this leads to an unreasonable result, plainly at variance with the policy of the legislation as a whole, we must examine the matter further. We may then look to the reason of the enactment, and inquire into its antecedent history, and give it effect in accordance with its design and purpose, sacrificing, if necessary, the literal meaning in order that the purpose may not fail. See Church of the Holy Trinity v. United States, 143 U. S. 457, 36 L. ed 226, 12 Sup. Ct. Rep. 511; Heydenfeldt v. Daney Gold & S. Min. Co., 93 U. S. 634, 638, 23 L. ed. 995, 996, 13 Mor. Min. Rep. 204. * * *."

In *U. S.* v. *Katz*, 271 U. S. 354, 357, Mr. Justice Stone, who delivered the opinion of the Court, made the following pertinent observations:

"All laws are to be given a sensible construction; and a literal application of a statute, which

would lead to absurd consequences, should be avoided whenever a reasonable application can be given to it, consistent with the legislative purpose. See Hawaii v. Mankichi, 190 U. S. 197, 212, 47 L. ed. 1016, 1020, 23 Sup. Ct. Rep. 787, 12 Am. Crim. Rep. 465, and cases there cited. In ascertaining that purpose, we may examine the title of the act (United States vs. Fisher, 2 Cranch, 358, 386, 2 L. ed. 304, 313; United States v. Palmer, 3 Wheat 610, 631, 4 L. ed. 471, 477; Church of the Holy Trinity v. United States, 143 U. S. 457, 462, 36 L. ed. 226, 229, 12 Sup. Ct. Rep. 516), the source in previous legislation of the particular provision in question (United States v. Saunders, 22 Wall. 492, 22 L. ed. 736; Viterbo v. Friedlander, 120 U. S. 707, 30 L. ed. 776, 7 Sup. Ct. Rep. 962; United States v. Morrow, 266 U. S. 531, 535, 69 L. ed. 425, 427, 45 Sup. Ct. Rep. 173), and the legislative scheme or plan by which the general purpose of the act is to be carried out. See Platt v. Union P. R. Co., 99 U. S. 48, 63, 64, 25 L. ed. 424, 429; Bernier v. Bernier, 147 U. S. 242, 246, 37 L. ed. 152, 154, 13 Sup. Ct. Rep. 244."

Chief Justice Marshall in *U. S.* v. *Fisher* et al., 3 Cranch 358, 386, 6 U. S. well said:

"* * * Where the mind labors to discover the design of the legislature, it seizes everything from which aid can be derived * * *."

When we cast our minds beyond Sections 11 and 12 and Section 101 to test the meaning of the term "net income," as used in Section 23 (n) as applied to the facts here, and explore other parts of the Act, the respondent's view of the law is confirmed.

Section 120 of the Revenue Act of 1932 provides as follows:

"In the case of an individual if in the taxable year and in each of the ten preceding taxable

years the amount of the contributions or gifts described in Section 23 (n) plus the amount of income, war-profits, or excess-profits taxes paid during such year in respect of preceding taxable years, exceeds 90 per centum of the taxpayer's *net income* for each such year, as computed without the benefit of section 23 (n), then the 15 per centum limit imposed by such section shall not be applicable." (Italics supplied.)

Does the term "net income," as used in Section 120 mean total net income subject to tax, or does it mean in the case of a "capital net loss," ordinary net income minus capital net loss?

The term "net income," cannot be contracted for the purpose of Section 23 (n), and expanded for other purposes. No such duplicity of purpose is evinced by the language of the Act.

Under the Act, each taxpayer has a definite total taxable net income which is not variable, and this amount without the deduction for contributions is the base for the purpose of the 15% limitation contained in Section 23 (n), irrespective of whether the taxpayer enjoyed a "capital net gain," or suffered a "capital net loss." Different parts of the net income may be subjected to different rates of tax, but the "net income," contemplated by Section 23 (n) is the whole of the parts as computed without the benefit of a deduction for contributions. Sections 11 and 12 impose normal taxes of 4% and 8%, and surtaxes of 1% to 55% on different parts of "ordinary net income." Section 25 provides for the allowance of credits for dividends and interest on United States obligations for normal tax purposes. Section 101 offers a special tax of 12½% on "capital net gain." Section 102 provides a limitation of 16% on the selling price of mines, oil or gas wells for surtax purposes.

Does the term "net income," as used in Section 131 of the Revenue Act of 1932 have a meaning at variance with the meaning of the same term as used in Section 23 (n)? Section 131 permits a credit against the tax imposed by Title I of the Act for income taxes paid to foreign countries and possessions of the United States. Section 131 (b) imposed a limitation on the credit and reads as follows:

> "(b) Limit on Credit. The amount of the credit taken under this section shall be subject to each of the following limitations:
>
> "(1) The amount of the credit in respect of the tax paid or accrued to any country shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's net income from sources within such country bears to his entire *net income* for the same taxable year; and
>
> "(2) The total amount of the credit shall not exceed the same proportion of the tax against which such credit is taken, which the taxpayer's net income from sources without the United States bears to his entire *net income* for the same taxable year." (Italics supplied.)

Does the term "net income," as used in Section 131 (b) mean "ordinary net income," minus "capital net loss" in the case of an American citizen who has sustained a "capital net loss," which is excluded in arriving at his net income subject to tax? The answer is "No," according to the General Counsel for the Department of the Treasury. In G. C. M. 16144, XV-9-7972, Cumulative Bulletin XV-1, January-June, 1936, p. 152, 155, it is stated in part as follows:

> "Where, however, there is a capital net loss instead of a capital net gain, the base of the tax

is not gross income computed under section 22 less deductions allowed by section 23. On the contrary, the base of the computation is the ordinary net income, although the tax on ordinary income is reduced by a percentage of the capital net loss. Therefore, the limitation under Section 131 (b) of the Revenue Act of 1932, where there is a capital net loss, would be expressed as follows:

$$\frac{\text{Net income from sources without U. S.}}{\text{Ordinary net income}} \times \text{U. S. tax} = \text{credit}$$

"* * * In answer to the specific questions submitted, it is held that:

"(1) The credit for foreign taxes may be allowed even though a taxpayer has a capital net loss from sources within the United States which exceeds his ordinary net income.

"(2) Where such capital net loss is less than the ordinary income, the denominator to be used under Section 131 (b) of the Revenue Act of 1932 is 'ordinary net income.'"

"If the term "net income," as used in Section 131 (b) were construed to mean "ordinary net income," minus "capital net loss," then the Congressional plan to limit the credit for foreign taxes would be frustrated. It would serve to enlarge the credit to the point of absorbing the entire U. S. tax.

G. C. M. 16144 holds that in the case of a *capital net loss* the taxpayer's *ordinary net income* is his *net income* within the meaning of that term as used in Section 131 (b) of the Revenue Act of 1932. We think this is a correct interpretation of the statute, and should apply with equal force to Section 23 (n).

We contend that in the case at bar, the respondent's entire net income for the year 1932 as computed with-

out the benefit of a deduction for contributions was $94,963.52 and that this is the base for the calculation of the 15% limitation on the deduction for contributions prescribed by Section 23 (n). G. C. M. 16144 definitely supports this view. It recognizes that a taxpayer's entire net income might consist of ordinary net income. The respondent's net income of $94,963.52 was computed under Sections 21, 22 and 23. The statute required it to be so computed.

The term "net income," is employed in other parts of the Act. If the Commissioner's interpretation of that term as used in Section 23 (n) were applied to the same term appearing elsewhere in the Act, the consequences would be absurd, and the legislative purposes would be nullified.

III

Congress by the adoption of the capital net loss provisions did not intend to deprive a taxpayer who has a taxable net income of a deduction for contributions.

Congress adopted the capital net loss provisions to discourage the practice of taxpayers of selling securities with a view to minimizing taxes. It was designed to protect the revenues of the Government. Section 23 (r) was of similar purpose. See *Edward J. White* v. *Commissioner*, B.T.A. Docket No. 82663, decided June 24, 1938, 37 B.T.A. —. The disallowed loss served to increase taxable net income, and therefore taxes.

Section 101 (b) required two computations of tax, and a taxpayer was required to follow the method that produced the greater tax. It was mandatory, not optional. This is explained in Article 503, Regulations 77, Income Tax, Revenue Act of 1932, reading as follows:

"Art. 503. Capital net losses.—Section 101 (b) provides for the determination of the tax in the case of any taxpayer (other than a corporation, but including the members of a partnership, an estate or trust, or the beneficiaries thereof) who in any taxable year sustains a capital net loss. A 'capital net loss' is the excess of the sum of the capital losses plus the capital deductions as defined in article 501, over the total amount of capital gain as therein defined. It is to be noted that, while the tax provided in section 101 (a) in the case of a capital net gain is to be imposed at the election of the taxpayer, the limitation with respect to a capital net loss provided in section 101 (b) will be applied irrespective of the taxpayer's election.

"In the case of any taxpayer, other than a corporation, who sustains a capital net loss for any taxable year, there shall be levied, collected, and paid, in lieu of the normal tax and the surtax imposed by sections 11, 12, 102, and 211, a tax determined as follows:

"A partial tax will first be computed upon the basis of the ordinary net income, as defined in section 101 (c) (7) and article 501, at the rates and in the manner provided in sections 11, 12, 102, and 211, and the total tax will be this amount minus 12½ per cent of the capital net loss, but in no case shall the tax under section 101 (b) be less than the tax computed without regard to the provisions of section 101. The application of this paragraph may be illustrated by the following example:

"**Example:** During 1932, A had an ordinary net income of $20,000 and a capital net loss of $13,000. He was entitled to a personal exemption of $1,000. The tax computed under section 101 (b) without applying the provision that in no case shall the tax under section 101 (b) be less than the tax computed without regard to the provisions of section 101, would be $175, computed as follows:

Ordinary net income	$20,000
Less credit for personal exemption	1,000
Balance subject to normal tax	19,000
Amount taxable at 4 per cent	4,000
Difference taxable at 8 per cent	15,000
Tax at 4 per cent (4 per cent of $4,000)	160
Tax at 8 per cent (8 per cent of $15,000)	1,200
Total normal tax	1,360
Surtax on $20,000	440
Total tax	1,800
Less: 12½ per cent of the capital net loss (12½ % of $13,000)	1,625
Amount of tax	175

"The tax computed without regard to the provisions of section 101 (b) would be $330," computed as follows:

Ordinary net income	$20,000
Capital net loss	13,000
Total net income	7,000
Less credit for personal exemption	1,000
Balance subject to normal tax	6,000
Amount taxable at 4 per cent	4,000
Amount taxable at 8 per cent	2,000
Tax at 4 per cent (4 per cent of $4,000)	160
Tax at 8 per cent (8 per cent of $2,000)	160
Total normal tax	320
Surtax on $7,000	10
Total tax	330

"The correct amount of A's tax is $330, since that amount is greater than the tax computed under section 101 (b) without applying the provisions that in no case shall the tax under section 101 (b) be less than the tax computed, without regard to the provisions of section 101."

Article 501 of Regulations 77 provides: "* * * The tax upon his *net income* from other sources, termed 'ordinary net income' is to be computed at the rates and in the manner provided in sections 11, 12, 102, and 211. * * *." (Italics supplied.)

(Please also see Paragraphs 4944 to 4955, inclusive, Prentice-Hall Tax Service, 1934, on the subject of the tax in the case of a capital net loss.)

This Court in *Helvering* v. *Bliss*, 293 U. S. 144, 150, said:

> "* * * nothing in Section 101, which prescribes merely a method for segregating a portion of that net income for taxation at a special rate, in any wise alters the right of the taxpayer to take the deduction in accordance with Section 23 (n)."

Congress by the adoption of Section 101 did not intend to deprive a taxpayer, who has a taxable net income under the Act, of a deduction for contributions. The legislative purposes of Sections 101 and 23 (n) are unrelated, and both may be effectually accomplished by giving the statute a fair and reasonable interpretation. Congress by Section 101 did not intend to legislate against the deduction for contributions.

In the *Bliss* case, supra, this Court recognized that net income consisting of ordinary net income must be taken into consideration in determining the base under Section 23 (n). The Commissioner now says that such net income reduced by the nondeductible capital net loss is the base. This Court also recognized that the deduction for contributions is a proper deduction in computing ordinary net income. The Commissioner now says that it is not.

Congress in Section 101 used language which safeguarded the ordinary deduction for contributions. Section 101 (c) (4) provides:

> "(4) 'Ordinary deductions' means the deductions allowed by section 23 other than capital losses and capital deductions."

The deduction for contributions is an ordinary deduction allowed by Section 23. Section 101 (c) provides:

> "(7) 'Ordinary net income' means the *net income*, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions." (Italics supplied.)

Ordinary net income is *net income*. The statute so provides.

In *C. C. Partee* v. *Commissioner*, B.T.A. Docket No. 81214, 37 B.T.A. —, (decided June 24, 1938), after the decision of the Court of Claims in the *Pleasants* case, it is stated:

> "'Ordinary net income' is 'net income' computed after excluding all items of capital gain, capital loss, and capital deductions. The ordinary net income of this petitioner * * * amounted to $45,247.25. Since section 101 provides that a partial tax shall be computed upon the basis of the ordinary net income at the rates and in the manner as if section 101 had not been enacted, "ordinary net income' for the purpose of that computation becomes 'net income.'"

A taxpayer's net income might consist solely of ordinary net income, or it might consist solely of capital net gain, or it might consist of both as happened in the *Bliss* case. But if he has a net income, he has the right to a deduction for contributions. The language of exclusion, "excluding all items of capital gain, capital loss, and capital deductions," following the word, "after," embraced either a capital net loss or a capital net gain. A taxpayer might have a capital net gain or a capital net loss. He cannot have both in the same taxable year. The language of exclusion was necessary in order to arrive at the net income subject to the normal and surtaxes prescribed by Sections 11 and 12, but in the computation of that net income, this Court in the *Bliss* case held that it

was proper to deduct the ordinary deduction for contributions. The language of exclusion did not exclude the ordinary deduction for contributions. Section 101 excluded capital deductions.

IV.

If it is considered that the language of the Act is obscure, then any resulting doubt should be resolved in favor of the taxpayer.

While we earnestly believe that the exemption of income from tax for contributions made, and using as the base for the calculation of the 15% limitation prescribed by Section 23 (n), *total net income subject to tax* as computed without the benefit of the deduction for contributions, irrespective of whether a taxpayer had a "capital net gain," or a "capital net loss," is free from ambiguity, yet if this Court is of the opinion that the language of the Act is obscure, then any resulting doubt should be resolved in favor of the respondent. This principle is well-settled, and was reiterated by Mr. Justice Sutherland, speaking for the Court in *U. S.* v. *Updike*, 281 U. S. 489, 496, in the following language:

> "It may be that the saving clause was not strictly necessary, but was inserted from excessive care to put the right of the taxpayer beyond dispute. In any event, we think this is the fair interpretation of the clause, and the one which must be accepted, especially in view of the rule which requires taxing acts, including provisions of limitation embodied therein, to be construed liberally in favor of the taxpayer. Bowers v. New York & A. Lighterage Co., 273 U. S. 346, 349, 71 L. ed. 676, 678, 47 Sup. Ct. Rep. 389."

This Court in the *Bliss* case, supra, 293 U. S. 144, 150-151, said:

"If the meaning of the Act were doubtful, we should still reach the same conclusion. The exemption of income devoted to charity and the reduction of the rate of tax on capital gains were liberalizations of the law in the taxpayer's favor, were begotten from motives of public policy, and are not to be narrowly construed. * * *"

CONCLUSION

In conclusion, we respectfully submit that the respondent is not to be deprived of his deduction for contributions by some such legal legerdemain; that the base contemplated by Section 23 (n) in the calculation of the 15% limitation on the deduction is the entire net income subject to tax as computed without the benefit of the deduction; that this rule applies equally to a capital net gain case as well as a capital net loss case; that in ascertaining "ordinary net income," both a "capital net gain," and a "capital net loss," are excluded; that in the *Bliss* case, supra, this Court permitted a deduction for contributions in ascertaining "ordinary net income"; that the statute did not prescribe one method of ascertaining "ordinary net income," in the case of a "capital net gain," and a different method of ascertaining "ordinary net income," in the case of a "capital net loss"; that the deduction for contributions is an "ordinary deduction," as applied to both types of cases in ascertaining "ordinary net income"; that Congress did not intend to impair or destroy the deduction for contributions through the introduction of the "capital net gain," and "capital net loss," provisions; that to construe the term "net income," as used in Section 23 (n) to mean "ordinary net income," minus "capital net loss," is to contravene the design of Congress to free from tax income subject to tax equal to the contributions made

within the 15% limitation, and to arrive at a fictitious net income which is not subjected to tax; taxable net income must be the base contemplated by Section 23 (n), because it was this base that was to be freed from tax; that the Commissioner determined the respondent's "net income," within the meaning of that term as used in Sections 11 and 12 to be $94,963.52 as computed without the benefit of the deduction for contributions; that the sum of $94,963.52 is the base contemplated by Section 23 (n) under the facts of this case; that the said sum of $94,963.52 constituted the respondent's entire net income for the year 1932; that the contributions in the sum of $3,496.00 made by the respondent during the year 1932 being within the 15% limitation prescribed by Section 23 (n) are properly deductible; that Section 23 (n) is entitled to a liberal construction in order to effectuate its beneficent purpose. that if the language of the Act is of doubtful meaning, such doubt should be resolved in favor of the respondent and that the judgment below should be affirmed.

Respectfully submitted,

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November, 1938.

FILE COPY

IN THE

Supreme Court of the United States

October Term, 1938

No. 169

THE UNITED STATES,
Petitioner

v.

FREDERICK PLEASANTS

ON A WRIT OF CERTIORARI TO THE COURT OF CLAIMS

SUPPLEMENTAL BRIEF FOR RESPONDENT

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The above case was argued before this Honorable Court on December 5, 1938. On that day, *White et al.* v. *U. S.*, Nos. 96, 97, was decided. That case held that upon a liquidation of a corporation stockholders' losses from their investment in its stock held for more than two years are not ordinary losses deductible in full, but are capital losses, the deductibility of which is limited by Section 101. On page 2 of the opinion, it is stated in part as follows:

> "These provisions of Sec. 23 are qualified and restricted by Sec. 101, which prescribes rates of tax applicable to capital net gains and the extent to which capital net losses are deductible in arriving at net taxable income. * * *."

Capital losses are deductible from capital gains in arriving at capital net gain, as defined by Section 101 (c) (5), subject to the 12½% tax. A capital net gain is the excess of the gains over losses. Capital losses are deductible to the extent of the capital gains, but the excess of the losses over gains, is a capital net loss within the meaning of that term as defined by Section 101 (c) (6), and such a net loss is not a permissible deduction under Section 23 (e). *Piper* v. *Willcuts*, (CCA 8), 64 F. (2d) 813, affirming 55 F. (2d) 397; *Hoffman* v. *Commissioner*, (CCA 2), 71 F. (2d) 929. In *Piper* v. *Willcuts*, supra, it was expressly recognized that a capital net loss is not a permissible deduction under Section 214 (a) (4) and (5) of the Revenue Act of 1926, which is similar to Section 23 (e) of the Revenue Act of 1932, in computing the taxpayer's net income, and *White et al* v. *U. S.*, is in harmony therewith. The general statutory concept of net income is covered by Sections 21, 22 and 23, but the general provisions of Sections 22 and 23 are subject to the special provisions of later sections in the Act forming part of Title I. Section 23 (e) is also subject to the limitation provisions of Section 118, loss from wash sales of stock or securities. Section 23 (e) of the Revenue Act of 1936 is also subject to the limitation contained in Section 24 (a) (6), as amended by Section 301 (a) (b) of the Revenue Act of 1937 disallowing losses from sales or exchanges of property between members of a family.

In the case at bar, the Commissioner determined the taxpayer's net income subject to the normal and surtaxes to be $94,963.52, and in the computation of that net income no deduction was allowed for the capital net loss of $154,921.98. We concede this to be correct under the statute, except for the deduction for contributions. We claim that contributions of

$3,496.00 should be deducted from $94,963.52, the provisional net income without contributions, and that $91,467.52 is the correct final net income subject to the normal and surtaxes. The question is very narrow. A taxpayer's total net income subject to tax, as computed without the benefit of the deduction for contributions, is the taxpayer's base as contemplated by Congress in Section 23 (n), because Congress intended to relieve from taxation income devoted to charity, and in order to effectuate that policy taxable net income is the measuring rod. It would be improper to use as a base an amount which is not net income subject to tax.

Our views are in entire harmony with *Helvering v. Bliss*, 293 U. S. 144. In that case, Mrs. Bliss had a total net income subject to tax of about $500,000, consisting of ordinary net income subject to the normal and surtaxes of $289,000 and capital net gain subject to the 12½% tax of $211,000. This Court held that the base under Section 23 (n) for calculating the 15% limitation was the total net income of $500,000 and that it was improper for the Commissioner to confine the 15% to the ordinary net income of $289,000.

We now have a case here where the taxpayer's total net income subject to tax consists entirely of his ordinary net income of $94,963.52, as computed without a deduction for contributions. Section 101 (c) (7) defines ordinary net income to mean the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions. The language of exclusion excludes a capital net gain or loss. Ordinary net income is net income computed in accordance with the general provisions of Sections 21, 22 and 23, as modified by Section 101 or any other provision forming a part of "this title," being Title I.

If $94,963.52 were not net income within the meaning of that term as used in Section 21, how could it be taxed as net income under Sections 11 and 12? Under the express mandate of Section 101 (c) (7) the net income must be computed in accordance with the provisions of "this title." Congress denominated ordinary net income as net income in order to enable the imposing provisions of Sections 11 and 12 to work. The provisions of the statute mesh when given a fair and reasonable interpretation in harmony with the legislative purposes. Prior to 1924, a taxpayer's losses sustained on sales were deductible in full, in consequence of which many taxpayers escaped income taxes altogether or greatly reduced the same. Congress by Section 101 of the 1924 Act prohibited the deduction of a capital net loss, the excess of losses over gains, in the same manner as Section 23 (r) prohibits the deduction of the excess of losses over gains on sales of securities held less than two years. Congress did not want a taxpayer to get the benefit of the net loss in computing net income subject to tax, and in that way, a taxpayer's net income was enlarged, and he had to pay more tax. The legislative history is clear. See report of Mr. Green, Chairman, Committee on Ways and Means, 68th Cong., 1st Session, Report No. 179, and his statement on the floor of the House in explanation of the capital net loss provisions. Vol. 65 Congressional Record, Part 3, 68th Congress, 1st Session, page 2428. Judge Green, the Chairman referred to, took part in the consideration and decision of the case at bar.

In the *Bliss* case, supra, it was held that the deduction for contributions was an ordinary deduction to be taken from ordinary net income. The taxpayer's statutory net income here consists entirely of his ordinary net income, and if contributions are deductible in computing ordinary net income in a capital

net gain case, which was the *Bliss* case, they are deductible in computing ordinary net income in a capital net loss case, because the term ordinary net income appearing in the statute means the same thing in each type of case.

Final net income means the base for calculation of the tax, as was held in the *Bliss* case, and that base in the instant case as computed without contributions is $94,963.52. A taxpayer who has a statutory net income for the calculation of the tax has a base under Section 23 (n), otherwise the evident purpose of Congress to encourage contributions is thwarted or defeated. The taxpayer here has been compelled to pay a tax on income which he gave to charity. Congress intended that it should be exempt from tax.

Respectfully submitted,

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December, 1938.

FILE COPY

IN THE

Supreme Court of the United States

OCTOBER TERM, 1938.

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FREDERICK PLEASANTS.

On a Writ of Certiorari to the Court of Claims.

BRIEF AS AMICUS CURIAE IN BEHALF OF HOWARD HEINZ.

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CASES CITED.

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BRIEF AS AMICUS CURIAE IN BEHALF OF HOWARD HEINZ.

PRELIMINARY STATEMENT.

Howard Heinz is the petitioner in the case of *Heinz* v. *Commissioner of Internal Revenue*, 94 F. (2d) 832, which is presently pending before the United States Circuit Court of Appeals, Third Circuit, on petition for rehearing, and also involves the 15 per cent limitation prescribed by Sec-

tion 23 (n) on the amount allowable as a deduction for contributions to charitable institutions.

Howard Heinz made contributions in 1931 of $45,910.37 and in 1932 $51,571.40, of which the Commissioner of Internal Revenue only allowed $28,031.86 for 1931 and $4,987.64 for 1932 as deductions for income tax purposes.

His *net income* subject to tax under Sections 11 and 12 of the Revenue Acts of 1928 and 1932, as computed without the benefit of the deduction for contributions, was $375,844.65 for 1931 and $412,017.69 for 1932. If these amounts constitute the base for the calculation of the 15 per cent limitation, Heinz's contributions are deductible in full.

Heinz sustained a *capital net loss,* as defined by Section 101 (c) (6), of $186,965.56 in 1931 and $378,766.79 in 1932, which amounts were not permissible deductions in computing the *net income* as aforesaid, and were not allowed as deductions by the Commissioner in computing the net which was taxed.

The Commissioner of Internal Revenue for the year 1931 only allowed as a deduction for contributions $28,031.86, being 15 per cent of $186,879.09, representing the difference between the *net income* subject to tax for that year of $375,844.65 as computed before the deduction for contributions, and the *capital net loss* of $186,965.56, and for the year 1932 he only allowed as a deduction for contributions $4,987.64, being 15 per cent of $33,250.09, representing the difference between the *net income* subject to tax for that year of $412,017.69 as computed before the deduction for contributions and the *capital net loss* of $378,766.79.

In the computation of the *net income* subject to tax under Sections 11 and 12 the Commissioner of Internal Revenue did not allow the *capital net loss* as a deduction, because Congress in the Revenue Acts of 1928 and 1932 expressly excluded it. The Commissioner of Internal Revenue levied the normal and surtaxes prescribed by Sections 11 and 12 on the *net income* as computed without the benefit of any deduction for the *capital net loss,* and properly so, and

against the taxes thus determined, a credit was allowed pursuant to Section 101 (b) of 12½ per cent of the capital net loss, the difference representing the tax due.

Heinz paid an income tax of $25,802.90 for 1931 and $108,842.23 for 1932. In addition thereto, there are outstanding deficiencies in income tax of $8,115.91 for 1931 and $22,633.73 for 1932, which deficiencies are in the main ascribable to the action of the Commissioner of Internal Revenue in cutting down on the deduction for contributions.

ARGUMENT.

The base for measuring the 15 per cent limitation on the deduction for contributions is the net income subject to tax, as computed without the benefit of the deduction, and not such amount diminished by a non-deductible capital net loss.

Section 23 (n) of the Revenue Acts of 1928 and 1932 expressly provided that in computing *net income* there shall be allowed as a deduction charitable contributions made within the taxable year to an amount which does not exceed 15 per cent of the taxpayer's *net income*, as computed without the benefit of the deduction. Its purpose was to encourage contributions to charitable institutions by according taxpayers a saving in tax through the medium of a deduction, and the statute therefore should be so construed to carry out this legislative plan.

The term "net income," is a statutory concept, and consists of gross income less authorized deductions. Its purpose was to provide a definite *base for the calculation of the tax.* The taxable base, as computed without the deduction for contributions, is the base contemplated by Section 23 (n) for the calculation of the 15 per cent limitation on the amount allowable as a deduction for contributions.

Article 41 of Regulations 77 under the 1932 Act provides as follows:

> "Art. 41. Meaning of net income.—The tax imposed by the Act is upon income. * * *."

The *net income* as computed by the Commissioner of Internal Revenue without the deduction for contributions as the base for the calculation of the normal and surtaxes prescribed by Sections 11 and 12 in the *Heinz* case was $375,844.65 for 1931 and $412,017.69 for 1932, and these amounts undiminished by the nondeductible *capital net loss* should afford the base for the calculation of the 15 per cent limitation.

The Commissioner did not deduct the *capital net loss* in arriving at the *net income* subject to tax under Sections 11 and 12, and therefore should not be permitted to deduct the *capital net loss* in ascertaining the *net income,* the base specified by Section 23 (n) for the calculation of the 15 per cent limitation. A *capital net loss* is not a permissible deduction in the computation of taxable net income. (*Piper* v. *Willcuts* (CCA 8), 64 F. (2d) 813, affirming 55 F. (2d) 397; *Hoffman* v. *Commissioner* (CCA 2), 71 F. (2d) 929.)

The Commissioner determined the net income subject to tax under Sections 11 and 12, as computed without the deduction for contributions, to be $375,844.65 for 1931 and $412,017.69 for 1932, but in the calculation of the 15 per cent limitation, however, the Commissioner used $186,879.09 for 1931 and $33,250.09 for 1932 as the base for measuring the limitation and thereby reduced the deduction for contributions. The amounts $186,879.09 for 1931 and $33,250.09 for 1932 represented the difference between the taxable *net income* as aforesaid and the nondeductible *capital net loss,* but were not used by the Commissioner as the *net income* in the imposition of taxes. The aforesaid amounts were in no sense the net income under the Acts for purposes of taxation. The Commissioner only used the said amounts for the purpose of Section 23 (n) in cutting down on the deduction for contributions. For the purpose of levying the normal and surtaxes prescribed by Sections 11 and 12, he used the enlarged *net income.* A taxpayer can only have one *net income* under the Act for a particular taxable year and that *net income* is the base for the calculation of the taxes.

The nondeductibility of a *capital net loss* in ascertaining taxable *net income* disadvantages a taxpayer. The capital net loss provisions in the statute were designed to protect the revenues of the Government, because the exclusion of a *capital net loss* served to increase taxable net income, and, therefore, taxes. Congress in the process of enlarging net income for the imposition of taxes evinced no intent to contract or destroy *net income* in the calculation of the deduction for contributions through the medium of deducting from gross income a nondeductible *capital net loss.* Such a course runs counter to the history of the legislation, and produces a contradiction not intended by Congress.

The fallacy of the Commissioner's view of the statute is clear when it is considered that Heinz paid an income tax of $108,842.23 on taxable net income for the year 1932, yet the Commissioner maintains that his *net income* for the purpose of Section 23 (n) is only $33,250.09. Congress without question contemplated that the *net income* which was the base under the Act for the imposition of taxes, as computed without the deduction for contributions, was also the base for the calculation of the 15 per cent limitation on the deduction for contributions, otherwise inconsistent meanings must be ascribed to the term *net income.*

While *Helvering* v. *Bliss*, 293 U. S. 144, did not involve the issue which is presented by the case at bar, and, therefore, is not controlling, that case, however, does afford light in the solution of the present question. That case held that the base for the calculation of the 15 per cent limitation was the total net income subject to tax, as computed without the benefit of the deduction for contributions, which in that case consisted of two parts (1) *net income* denominated by the Act as ordinary net income, subject to tax under Sections 11 and 12, and (2) *net income* consisting of capital net gain, subject to the 12½ per cent tax prescribed by Section 101. The total of these two parts represented the base for the calculation of taxes and was held to be the base for the calculation of the 15 per cent limitation. The base

in the case at bar for the calculation of taxes consists of only one part *ordinary net income*, which is the taxpayer's sole net income, and, therefore, is the correct base for measuring the 15 per cent limitation here.

Section 101 (c) (7) provides:

> "(7) 'Ordinary net income' means the *net income*, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions."

Section 101 (c) (7) expressly denominated ordinary net income as *net income*. If it were not net income, it could not have been taxed under Sections 11 and 12. These sections authorize a tax on *net income*. The Commissioner of Internal Revenue subjects the ordinary net income undiminished by the nondeductible *capital net loss* to tax under Sections 11 and 12 as the *net income* contemplated by those sections. Since it is the *net income* for the purpose of Sections 11 and 12, it follows that it is also the *net income* for the purpose of Section 23 (n). The purpose of Congress in fixing *net income* was to arrive at a base for the calculation of taxes, and it is that base, as computed before the deduction for contributions is taken, which measures the 15 per cent limitation. The taxable *net income* less the nondeductible *capital net loss* is not the base used in the calculation of taxes, and, therefore, is not the correct base for ascertaining the 15 per cent limitation.

Section 21 of the Revenue Act defined "net income," to mean the gross income computed under Section 22, less the deductions allowed by Section 23. The general statutory concept of net income was covered by these sections. The existence of income tax liability depends on the existence of statutory net income within the meaning of that term as used in Section 21. Sections 11 and 12 lay a tax on net income. These sections could not operate on the subject matter unless net income existed within the meaning of that term as used in Section 21. Section 101 (c) (7) denomi-

nates ordinary net income as net income. It must be net income within the meaning of that term as used in Section 21, otherwise it could not have been treated as net income by the Commissioner for the purpose of imposing the tax prescribed by Sections 11 and 12.

The general language of Sections 22 and 23 was to some extent modified by special language contained in later sections of the Act, all part of Title I of the Act. For example, Section 118 prohibited the deduction of a loss under Section 23 (e) on the sale of securities where within 30 days before or after the sale the taxpayer has acquired substantially identical property. Section 120 provides that the 15 per cent limit imposed by Section 23 (n) on the deduction for contributions does not apply under certain circumstances. There are many others that affect the computation of the net which is taxed.

General language in a statute must always yield to special language that covers a particular subject. *United States* v. *Chase,* 135 U. S. 255, 260; also *Ginsberg & Sons* v. *Popkin,* 285 U. S. 204.

A taxpayer is only entitled to such deductions from gross income as are authorized. In *Helvering* v. *Independent Life Ins. Co.,* 292 U. S. 371, 381, this Court said:

> "Unquestionably Congress has power to condition, limit, or deny deductions from gross income in order to arrive at the net that it chooses to tax."

Congress by Section 23 (e) did not authorize a deduction of a capital net loss. A capital net loss is the excess of losses over gains on sales of capital assets. Congress specially legislated against such a deduction in computing the net that it chose to tax. If it were deductible under Section 23 (e) why didn't the Commissioner allow it?

The term "ordinary net income," as defined by Section 101 (c) (7) means the same thing regardless of whether a taxpayer had a capital net gain, or a capital net loss. The term cannot have conflicting meanings. The same method

of arriving at ordinary net income must be used in each type of case. If the deduction for contributions is an ordinary deduction to be taken in whole from ordinary net income in a *capital net gain* case, as was held in the *Bliss* case, *supra,* it is likewise an ordinary deduction to be taken in whole from ordinary net income in a *capital net loss* case. There is no cogent reason for differentiation, and the statute suggests none. The legislative objective of the capital net loss provisions was to deny a deduction of a capital net loss in computing the net income subject to the normal rates of 4 and 8 per cent, and surtax rates of 1 to 55 per cent under Sections 11 and 12 of the Revenue Act of 1932. This disadvantaged the taxpayer, but advantaged the revenues of the Government. The statute does not contain any suggestion that Congress wanted to further augment the revenues of the Government by denying or cutting down on the deduction for contributions.

The cases of *Elkins* v. *Commissioner,* 24 B. T. A. 572, and *Livingood, Executor* v. *Commissioner,* 25 B. T. A. 585, dealing with capital net loss, should not be confused with cases dealing with capital net gain. In each case, it is only necessary to determine the taxpayer's *net income.* A taxpayer who has a capital net gain has a net income which is different from that existing in a capital net loss case.

The Commissioner's administrative practice on the question at issue has been confusing. I. T. 2104 did not provide that in computing net income, a *capital net loss* is deductible. I. T. 2104 dealt only with capital losses. Capital losses are deductible from capital gains in determining capital net gain subject to the 12½ per cent tax. Capital losses are deductible to the extent of capital gains in ascertaining a capital net loss. The excess of the losses over gains constitutes a capital net loss. I. T. 2104 does not hold that a capital net loss is deductible in computing a net loss which is deductible under Section 206 of the Revenue Act of 1924. Section 206 (a) (2) provides that in computing a net loss:

"In the case of a taxpayer other than a corporation, deductions for capital losses otherwise allowed by law shall be allowed only to the extent of the capital gains;"

The excess represents a capital net loss which is not deductible. The Commissioner has never allowed a *capital net loss* as a deduction, and I. T. 2104 does not deal with that subject.

The administrative practice is not helpful to the Commissioner. Where the department decides a question two ways, neither decision can be given the effect usually given to an established practice of an executive department. *U. S.* v. *Coulby,* 258 Fed. 27. In *The Dollar Savings Bank* v. *U. S.,* 86 U. S. 227, it was held that where an Internal Revenue Act was not susceptible of the construction given to it by the Commissioner of Internal Revenue, the reenactment of the statute subsequent to the construction placed thereon was not to be regarded as a legislative adoption of that construction. This Court, speaking through Mr. Justice Strong, said (p. 237):

> "* * * Hence, it is inferred, the construction given by the commissioner was adopted. It is, doubtless, a rule that when a judicial construction has been given to a statute, the re-enactment of the statute is generally held to be in effect a legislative adoption of that construction. This, however, can only be when the statute is capable of the construction given to it, and when that construction had become a settled rule of conduct. The rule, we think, is inapplicable to this case. In the first place, the decisions of the internal revenue commissioner can hardly be denominated judicial constructions. That officer was not required by the law to prescribe what returns savings banks were required to make. That was prescribed by the Act of Congress itself, and he had no power to dispense with the requisition. There is, therefore, no presumption that his decisions were brought to the knowledge of Congress when the act of 1870 was passed. And again, the construction he gave is an impossible one, for, as we have seen, it makes the proviso plainly repugnant to the body of the section."

If legislative adoption of a prior construction has wei here, then the taxpayer has greater standing. *Elkin Commissioner*, 24 B. T. A. 572, was decided in favor of taxpayer on the issue in question on November 3, 1931, *Livingood, Executor* v. *Commissioner*, 25 B. T. A. 585, in favor of the taxpayer, was decided February 23, 19 Congress by Section 23 (n) of the Revenue Act of 1932, proved June 6, 1932, reenacted Section 23 (n) of the Re nue Act of 1928 authorizing a deduction for contributi in the same language, and in the face of the prior const tion by the Board of Tax Appeals.

CONCLUSION.

In conclusion, we submit that the decision bel *Pleasants* v. *U. S.*, 22 F. Supp. 964, is a correct interpre tion of the statute, and should be affirmed.

Respectfully submitted,

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FILE COPY

IN THE

Supreme Court of the United States

October Term, 1938.

No. 169.

THE UNITED STATES,
Petitioner,

v.

FREDERICK PLEASANTS.

On a Writ of Certiorari to the Court of Claims.

Brief as Amicus Curiae in Behalf of John E. Zimmermann.

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ON A WRIT OF CERTIORARI TO THE COURT OF CLAIMS.

BRIEF OF AMICUS CURIÆ IN BEHALF OF JOHN E. ZIMMERMANN.

PRELIMINARY STATEMENT.

JOHN E. ZIMMERMANN is the Petitioner in the case of Zimmermann v. Commissioner of Internal Revenue, which is presently pending on appeal before the United States Circuit Court of Appeals, Third Circuit, No. 6759, March Term 1938 Sur Petition for Review from the United States Board of Tax Appeals and involves the question of the 15 per cent. limitation prescribed by Section 23 (n) of the Revenue Act of 1932 on the amount allowable as a deduction in computing taxable net income for the contributions made to charitable institutions.

In 1932 Mr. Zimmermann had an ordinary net income of $129,434.81, exclusive of capital net loss. During this year he made charitable contributions of $19,122.32, which were less than 15 per cent. of such ordinary net income. The Commissioner originally allowed $17,178.64 thereof as deductions, but later refused to allow such $17,178.64 as a deduction in computing tax on such ordinary net income, on the ground that for such year Mr. Zimmermann claimed a capital net loss of $267,252.87. Accordingly, the Commissioner computed tax on the full $129,434.81 in the sum of $45,197.34, allowing a credit against such tax of 12½ per cent. of the capital net loss, or $33,406.61, resulting in a tax of $11,632.23, whereas, if the charitable gifts had been alowed as a deduction against ordinary net income, no tax would have been payable.

ARGUMENT.

Where a Taxpayer Has a Net Income on Which He Must Pay an Income Tax, Congress, in Order to Encourage Gifts to Charity, Granted the Privilege of Deducting Such Gifts to the Extent of 15% of Such Taxable Net Income.

Section 23 of the Revenue Act of 1932 (similar to prior Revenue Acts since October 3, 1917) provides that in computing net income there shall be allowed as deductions:

> "(n) Charitable and Other Contributions.—In the case of an individual, contributions or gifts made within the taxable year to or for the use of: . . .
>
> '(2) a corporation, or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary or educational purposes, . . . to an amount which in all the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this subsection . . . '"

This Court, in Helvering v. Bliss, 293 U. S. 144, at p. 147, recognized that Congress intended by this section to encourage gifts to religious, educational and other charitable objects and stated:

> "Nor should the reduction in the rate of tax on capital gain first granted in the Revenue Act of 1921 be held to circumscribe the privilege granted in the earlier acts and retained in later ones with respect to charitable contributions unless that result be plainly required by the language used."

Similarly, the provisions, first appearing in the Revenue Act of 1924, limiting the extent to which capital net

losses (12½% thereof) could be used to reduce the total tax liability, should not be construed to deny to a taxpayer sustaining a capital net loss, the deduction for contributions which Congress admittedly intended to encourage.

This, however, is the precise effect of the Government's interpretation of the statute. Mr. Zimmerman, during 1932, had made contributions to charities amounting to $17,178.64, and in the same year suffered a capital net loss of $267,252.87, and had a net income, before deducting gifts to charities, of $129,434.81.

Under the Commissioner's theory, which we submit is erroneous, he construes the law as requiring the following computation of taxable net income and tax:

COMMISSIONER'S COMPUTATION.

Income

Net Income (before deduction of contributions)		$129,434.81

Deductions

Capital Net Loss	$267,252.87	
Contributions (allowable)	None	— 267,252.87
Net Income (none) Net loss		—$137,818.06

Therefore he allows no deduction for contributions.

Now, to find the Net Income on which he computes tax, he adds back the Capital Net loss of + $267,252.87

resulting in Ordinary Net Income of 129,434.81

The normal tax and surtax imposed by Sections 11 and 12 on $129,252.87 (less $158.50 credit for tax paid at source) is	$45,038.84
minus credit 12½% of Capital Net Loss of $267,252.87 or—	33,406.61
Total Tax determined by Commissioner—	$11,632.23

The Commissioner thus levies a tax of $11,632.23 despite his finding that the taxpayer had no net income.

It is respectfully submitted that no such construction was ever intended by Congress nor can it be found in the Act. There is no provision of the law that requires a Capital Net Loss to be deducted in computing the Net Income on which the 15 per cent. allowance for contributions is to be made and then, after determining the deduction or contributions, to add back to the net result the Capital Net Loss. The effect of the Commissioner's theory as shown by the above computation is that he levies a tax on the Capital Net Loss and then reduces the tax by 12½ per cent. of the Capital Net Loss to determine the Total Tax payable.

We submit that a correct construction of the law requires the computation to be made in the folowing manner:

Income	
Net Income (before deduction of contributions)	$ 129,434.81
Deductions	
Contributions (not more than 15% of net income of $129,252.87)	17,178.64
Ordinary Taxable Net Income	$ 112,256.17

The tax imposed by Sections 11 and 12 on $112,256.17 (less $158.50 credit for tax paid at source)	34,259.94
Minus credit 12½% of Capital Net Loss of $267,252.87	33,406.61
The total tax determined under Section 101 (b) to be collected and paid under Section 101 (d) is	$ 1,853.33

The Term "Net Income," as Used in Sec. 23 (n) of the Revenue Act of 1932 Granting a Taxpayer a Deduction for Contributions to Charities Means the Taxable Net Income Exclusive of Capital Net Loss and Does Not Mean That Net Income Minus Deduction for Capital Net Loss.

Under the Revenue Act a taxpayer with a net income of over $16,000 who has sustained a capital net loss must compute his taxable net income and is taxed thereon under Sections 101 (b) (c) and (d). He has no such election as is given under Section 101 (a) to a taxpayer who has a capital net gain.

This construction is supported by the language of Section 12 (c) which, while not a substantive provision, nevertheless indicates clearly the meaning which Congress intended to give to "net income" in cases involving capital losses.

> "(c) Capital Net Gains and Losses.—For rate and computation of tax in lieu of normal and surtax . . . in case of net incomes, excluding items of capital gain, capital loss, and capital deductions of not less than $16,000, approximately, see Section 101."

The language of Section 101 (b) is perfectly explicit:

> "(b) *Tax in Case of Capital Net Loss.*—In the case of any taxpayer, other than a corporation, who for any taxable year sustains a capital net loss (as hereinafter defined in this section), there *shall be* levied, collected and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: *a partial tax* shall first be computed upon the basis of the *ordinary net income* at the rates and in the manner as if this section had not been enacted, and the total tax shall be this amount minus 12½ per centum of the capital net loss; but in no case shall the tax of a taxpayer who has sustained a capital net loss be less than the tax computed without regard to the provisions of this section." (Italics supplied.)

By Section 101 (c) (7), *ordinary net income* is defined as follows:

> "(7) 'Ordinary net income' means the net income computed in accordance with the provisions of this title, after *excluding all items* of capital gain, *capital loss,* and capital deductions." (Italics supplied.)

By this explicit language, in computing "ordinary net income" capital losses are excluded. In case of a taxpayer with a salary of $20,000, and capital losses of $20,000, his "ordinary net income," on which the partial tax is to be computed under the above formula, certainly is $20,000, *because it is expressly provided that his $20,000 capital net loss is excluded.* In making such partial computation, his deduction for charitable contributions must therefore be figured on the basis of this $20,000 income without deduction for the $20,000 capital losses, which Section 101 (b) and (c) (7) expressly requires to be excluded.

Having computed the partial tax on the above basis, Sec. 101 (b) provides that, from the amount of tax thus ascertained, there shall be deducted 12½ per cent. of the $20,000 capital net loss.

The language of the statute is explicit. To sustain the Commissioner's contention, this explicit language must be arbitrarily disregard, for the purpose, not of giving the benefit of the doubt in favor of the taxpayer, but of imposing an additional tax not called for by the words of the statute or consistent with its object; with the result, not of encouraging gifts to charity, but of manifestly discouraging them.

The construction of the statute contended for by the taxpayer in this case is entirely in harmony with the decision of this Court in the case of *Helvering v. Bliss*, supra.

The decision in the *Bliss* case was based on the principle that the Act is to be construed so as to promote the obvious purpose to encourage gifts to charity, and, in case of doubt, in favor of the taxpayer:

> "If the meaning of the Act were doubtful, we should still reach the same conclusion. The exemption of income devoted to charity and the reduction of the rate of tax on capital gains were liberalizations of the law in the taxpayer's favor, were begotten from motives of public policy, and are not to be narrowly construed."

The manifest unreasonableness and unfairness of the construction of the Act advocated by the Commissioner is apparent when one considers the practical manner in which charitable contributions are made.

A taxpayer with a large salary or income from investments can, at the beginning of the year, estimate, with rea-

sonable accuracy, the amount of his income. The Government, in the tax law, tells him that, to the extent of 15 per cent. of his ordinary income, he may deduct charitable contributions in figuring income tax.

The solicitation of charitable contributions is not confined to the last months of the year, but goes on throughout the year; and such contributions must be made from time to time.

Capital losses may, however, occur at any time throughout the year, including the end of the year.

It is manifestly unfair that a taxpayer who has fixed the amount of its charitable contributions on the basis of the deductibility of a certain percent. in computing income tax, should be denied such right of deduction because of tax losses late in the year which have rendered him even less able to afford the contributions.

If a taxpayer realizes large capital gains toward the end of the year, he still has time to make additional contributions which he can then afford. He cannot, however, after incurring capital losses, take back contributions which he has already made.

A totally unfair and unreasonable result of applying the Commissioner's interpretation to the statute is also seen by examining Section 120 which provides that, where a taxpayer, for the current taxable year and in each of the preceding ten years, has given over 90 per cent. of his net income (after deducting income, war profits and excess profits taxes paid) to charity, there shall be no limitation on the deduction of such contributions.

Assume that in a taxable year taxpayers A and B each had $300,000 taxable net profit from business and $300,000 of capital net losses, and each contributed in that year

$270,000 to charity. Taxpayer A, however, had contributed over 90 per cent. of his income for the past ten years, but taxpayer B had, for the first time, determined to emulate taxpayer A's example and duplicate his gifts to charity. Under the Commissioner's construction, supra, taxpayer A would be entitled to deduct the entire $270,000 of contributions, but taxpayer B, who, of course, may not deduct the entire $270,000 of contributions, since he has not fulfilled the ten-year requirement, is denied by the Commissioner even the 15 per cent. deduction provided by Section 23 (n). It is respectfully submitted that Congress never intended such a result, nor is it required by the explicit wording of the statute, as is pointed out supra.

We submit that the decision below, *Pleasants v. United States*, 22 F. Supp. 964, is a correct interpretation of the statute and should be affirmed.

Respectfully submitted,

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SUPREME COURT OF THE UNITED STATES.

No. 169.—October Term, 1938.

The United States, Petitioner, *vs.* Frederick Pleasants.	On Writ of Certiorari to the Court of Claims.

[January 3, 1939.]

Mr. Chief Justice Hughes delivered the opinion of the Court.

The question is whether the 15 per centum allowed as a deduction for charitable contributions under Section 23(n) of the Revenue Act of 1932 is to be calculated on the taxpayer's net income computed without regard to a capital net loss as to which special provision is made by Section 101(b).

Section 23(n) provides that in computing net income there shall be allowed as a deduction from gross income—

"In the case of an individual, contributions or gifts made within the taxable year to or for the use of: . . . to an amount which in all the above cases combined does not exceed 15 per centum of the taxpayer's net income as computed without the benefit of this subsection".

Respondent in 1932 made charitable contributions to the amount of $3496. His net income, irrespective of a capital net loss, was determined by the Commissioner to be $94,963.52. Upon that net income the Commissioner assessed the normal tax and surtax at the rates prescribed by Sections 11 and 12.[1] Respondent contended that this was his net income as described in Section 23(n) and that as his charitable contributions were less than 15 per centum of that

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[1] These sections provide:

"Sec. 11. *Normal Tax on Individuals.*—

"There shall be levied, collected and paid for each taxable year upon the net income of every individual a normal tax equal to the sum of the following:

"Sec. 12. *Surtax on Individuals.*—

"(a) *Rates of Surtax.*—There shall be levied, collected, and paid for each taxable year upon the net income of every individual a surtax as follows: . . ."

amount they were deductible in full in determining his normal tax and surtax. The Commissioner refused to allow the deduction.

The taxpayer had sustained a "capital net loss", as defined in Section 101(c)(6), of $154,921.98. The Commissioner ruled that "Since the capital loss of $154,921.98 is in excess of adjusted ordinary net income of $94,963.52 (without contributions) there is no net income against which to make a deduction for contributions".

Having paid the tax assessed by the Commissioner upon that theory, respondent filed his claim for a refund and on its rejection brought this suit in the Court of Claims. Judgment was rendered in his favor. 22 F. Supp. 964. Because of an asserted conflict with decisions of Circuit Courts of Appeals[2] and with our ruling in *Helvering v. Bliss,* 293 U. S. 144, certiorari was granted. October 10, 1938.

"Capital net gains" and "capital net losses" of individual taxpayers are the subject of special treatment under Section 101. In the case of a "capital net gain", there is to be levied, at the election of the taxpayer, and in lieu of all other taxes imposed by the income tax title, a tax of 12½ per centum of the capital net gain, to be added to the tax computed upon the basis of the "ordinary net income". Sec. 101(a). In the case of a "capital net loss", Section 101(b) provides for a tax to be determined, also in lieu of other income taxes but irrespective of any election by the taxpayer, as follows:

"a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted, and the total tax shall be this amount minus 12½ per centum of the capital net loss; but in no case shall the tax of a taxpayer who has sustained a capital net loss be less than the tax computed without regard to the provisions of this section".

Section 101(c)(6) defines "capital net loss" as "the excess of the sum of the capital losses plus the capital deductions over the total amount of capital gain". Section 101(c)(7) defines "ordinary net income" as "the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions".

There is no doubt as to the purpose of this provision as to capital net losses which was first introduced in the Revenue Act of 1924.[3]

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[2] Avery v. Commissioner, C. C. A. 7th, 84 F. (2d) 905; Lockhart v. Commissioner, C. C. A. 3d, 89 F. (2d) 143; Heinz v. Commissioner, C. C. A. 3d, 94 F. (2d) 832.

[3] Revenue Act of 1924, Sec. 208(c).

Prior to that time, and under the Revenue Act of 1921, capital losses were to be deducted from capital gains in the process of determining the "capital net gain".[4] If capital deductions and capital losses were in excess of the capital gain, or if there were capital losses in the absence of capital gain, such losses were deductible as ordinary losses. We are told that the opportunity to minimize taxes by the practice of taking capital losses to offset ordinary net income constituted a particularly serious problem after the Act of 1921, which reduced the rate of tax on capital net gains. The results to the Treasury of that method of treating capital losses led to the adoption in the Act of 1924 of the plan for subjecting capital net losses to a limited rate in order to protect the revenues,[5] a plan which was continued in the Revenue Acts of 1926, 1928 and 1932.[6]

It will be observed that the provision for the limitation with respect to a capital net loss under Section 101(b) (unlike the provision in Section 101(a) as to a capital net gain) gives no option to the taxpayer.[7] The limitation is explicit and must be followed as written. The limitation applies equally when there is no capital gain and hence nothing to be deducted from capital losses on that score.[8] The limitation is applicable unless, as stated in the last clause of Section 101(b), a greater tax would result from not applying it.[9] In the instant case there is no question that the limitation does apply and the Commissioner has applied it.

In such a case the statute directs that a partial tax shall be first computed upon the basis of the "ordinary net income" and at the rates and in the manner provided in Sections 11 and 12.[10] The total tax is then arrived at by deducting 12½ per centum of the capital net loss. That loss thus figures in the computation of the total tax only by the allowance of an offset to the specified extent against the tax determined apart from the capital losses. Thus where the limitation is applicable and the offset of 12½ per centum of the capital net loss is allowed accordingly, capital losses are not deductible in determining the taxpayer's net income for the pur-

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[4] Revenue Act of 1921, Sec. 206(a) (4).

[5] Piper *v.* Willcuts, 64 F. (2d) 813, 815, 816; 65th Cong. Rec. 2428; H. Rep. 179, 68th Cong., 1st sess., p. 20.

[6] Revenue Act of 1926, Sec. 208(c); 1928, Sec. 101(b); 1932, Sec. 101(b).

[7] Regulations 77, Art. 503.

[8] See Piper *v.* Willcuts, 64 F. (2d) 813, 816; Hoffman *v.* Commissioner, 71 F. (2d) 929.

[9] See illustration in Regulations 77, Art. 503.

[10] See Note 1.

pose of the normal tax and surtax. And, as in such case there is no capital gain, the "ordinary net income" under Section 101(b), that is, the net income computed after excluding capital loss and capital deductions, is the only net income upon which a tax is laid.

We have noted that the limitation of Section 101(b) is not applicable if the tax, computed without regard to that section, would be greater. The latter method of computation brings out the distinction clearly. For in that method the capital net loss is deducted from the ordinary net income in order to arrive at the total net income for the purpose of applying the normal tax and surtax rates. See illustration in Regulations 77, Article 503. But where the limitation of Section 101(b) governs, because the tax as otherwise computed would not be greater, capital losses are not deducted in determining the net income which is to be taxed, but are used only for the purpose of determining the specified offset against the tax on that net income. *Id.*

We are not impressed with the argument based on the provisions of Sections 21, 22 and 23. True, Section 21 provides that "net income" means gross income computed under Section 22 less the deductions allowed by Section 23. Section 22 defines gross income and Section 23 provides for deductions, including deductions for losses. But Sections 21, 22 and 23 are not to be construed so as to derogate from the special and explicit provisions of Section 101(b). Under the limitation of that section, as we have seen, the taxpayer is not permitted to deduct capital losses so as to reduce the net income subject to tax and his capital losses enter into the computation of his ultimate tax only through the deduction of 12½ per centum of the capital net loss from the tax which is computed upon the net income ascertained irrespective of that loss.

It is in this light that we must decide the particular question here presented as to the meaning of the words "the taxpayer's net income" in Section 23(n) providing for a deduction of 15 per centum for charitable contributions. Do these words refer to the taxpayer's net income which under the statutory scheme is actually subject to tax? Or is that net income, although treated as subsisting for the purpose of being taxed, to be regarded as non-existent for the purpose of admitting deductions for contributions? We think that Congress, in the application of the special provision of Section 101(b) for an offset in case of a capital net loss, intended to make the taxpayer's net income, ascertained irrespec-

tive of that loss, the subject of the tax and that the provision in Section 21(n) allowing a deduction for charitable contributions is applicable to that taxable net income.

There is nothing to the contrary in our decision in *Helvering* v. *Bliss, supra.* In that case there was a capital net gain. The net income of the taxpayer comprehended that net gain as well as his net income otherwise computed. We decided that it was his total net income which was to be regarded as the basis for the allowance under Section 23(n). We found nothing in Section 101, which in that application prescribed "merely a method for segregating a portion of that net income for taxation at a special rate", that in any wise altered the right of the taxpayer to take the deduction in accordance with Section 23(n). *Id.*, 150, 151. Here, instead of a capital net gain, we have a capital net loss. There is no gain to be added to the taxpayer's net income otherwise computed, and thus that is the only net income taxable under the statute. To that net income, the provision of Section 23(n) appropriately applies. We observed in the *Bliss* case that the exemption of income devoted to charity and the reduction of the rate of tax on capital gains "were liberalizations of the law in the taxpayer's favor, were begotten from motives of public policy, and are not to be narrowly construed". That observation is equally pertinent here.

The administrative construction invoked by the Government has not been of a sufficiently consistent character to afford adequate support for its contention.[11]

We conclude that the Commisioner erred in refusing to permit the deduction sought by respondent for his charitable contributions and that the judgment of the Court of Claims should be affirmed.

Affirmed.

A true copy.

Test:

Clerk, Supreme Court, U. S.

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[11] See I. T. 2104, III-2 Cum. Bull. 152; Elkins *v.* Commissioner, 24 B. T. A. 572; Livingood *v.* Commissioner, 25 B. T. A. 585, 589; XI-1 Cum. Bull. 9, 33; XI-2 Cum. Bull. 3, 6, 29, 268; Straus *v.* Commissioner, 27 B. T. A. 1116; XIII-2 Cum. Bull. 25, 29, 135.